CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 13

THE UNITED STATES OF AMERICA, PETITIONER

vs.

ASHBY OLIVER STEWART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JANUARY 26, 1940
CERTIORARI GRANTED MARCH 25, 1940

BLANK PAGE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 13

THE UNITED STATES OF AMERICA, PETITIONER

vs.

ASHBY OLIVER STEWART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

INDEX

	Page
Record from D. C. U. S., Northern District of California	1
Names and addresses of attorneys	1
Petition	2
Exhibit A—Protest	13
Exhibit B—Claim for refund	16
Exhibit C—Notice of disallowance of claim	23
Answer	25
Stipulation of facts	30
Opinion, Lindley, J	35
Order amending findings of fact nunc pro tunc	41
Judgment	43
Statement of evidence	44
Appearances	44
Opening statement	45
Testimony of A. O. Stewart	58
Plaintiff's exhibits:	
1—Pamphlet issued by the treasury department entitled "The Farm Loan Primer," circular No. 5 Federal Farm Loan Board	64
2—Federal Farm Loan Board Circular No. 9	67
3—Portion of the Opinion of the Hon. Charles E. Hughes	70
4—Pages from "The Borrowers Bulletin" issued by the Federal Farm Loan Bureau	72
5—Federal Farm Loan Bureau Circular No. 12	75

240118—40

Record from D. C. U. S., Northern District of California—Con.
Statement of evidence—Continued.
Testimony of A. O. Stewart—Continued.
Plaintiff's exhibits—Continued. Page
6—Opinion of the General Counsel of the Bureau of Internal Revenue dated April 3, 1933 85
7—Letter dated May 2, 1933, to all Joint Stock Land Banks from the Secretary of the Federal Farm Loan Bureau 94
8—Closing agreements between the Commissioner of Internal Revenue and 7 Joint Stock Land Banks 99
9—Ruling of the General Counsel of the Farm Credit Administration dated September 12, 1934 103
10—Ruling of the Assistant General Counsel of the Bureau of Internal Revenue dated February 28, 1935 106
Colloquy 115
Defendant's motions for judgment 116
Notice of appeal 117
Bond on appeal 117
Stipulation designating record on appeal 120
Order to transmit original exhibits 121
Stipulation and order extending time 122
Clerk's certificate 123
Statement of points to be relied on by appellant 125
Proceedings in U. S. C. C. A., Ninth Circuit 128
Order of submission 128
Order directing filing of opinion and judgment 128
Opinion, Garrecht, J 128
Judgment 135
Clerk's certificate 136
Order extending time within which to apply for writ of certiorari 136
Order allowing certiorari 137

NAMES AND ADDRESSES OF ATTORNEYS OF RECORD:

W. G. HARMON, Esq.,
ERNEST L. WILKINSON, Esq.,
J. EDWARD JOHNSON, Esq.,
206 Sansome Street,
San Francisco, California,
Attorneys for Plaintiff and Appellant.

FRANK J. HENNESSY, Esq.,
United States Attorney.
ESTHER B. PHILLIPS,
Assistant United States Attorney.
Post Office Building,
San Francisco, California.
Attorneys for Defendant and Appellee.

In the United States District Court in and for the Northern District of California, Northern Division.

No. 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

PETITION

Ashby Oliver Stewart brings this petition against the United States of America, pursuant to the provisions of Section 41, Paragraphs (5) and (20) of Title 28 of the United States Code, and, for a cause of action alleges as follows:

I. Your petitioner resides in the City of Atherton, in the County of Santa Clara, State of California.

II. The nature of your petitioner's claim is for a refund of income taxes not exceeding $10,000.00 erroneously and unlawfuly assessed against your petitioner, and collected from your petitioner for the year 1931.

III. Prior to the year 1931, your petitioner purchased bonds with appurtenant accrued and unaccrued interest coupons, issued under the provisions of the Federal Farm Loan Act of 1916 (29 Stat. 360, amended 41 Stat. [1*] 1454) by the Kansas City

*Page numbering appearing at the foot of page of original certified Transcript of Record.

Joint Stock Land Bank, (a Corporation organized under the provisions of said Federal Farm Loan Act), in the aggregate principal amount of $886,000, for the sum of $504,275.74. In 1931, your petitioner surrendered to the Receiver of said Kansas City Joint Stock Land Bank (who was duly appointed as such Receiver by the Federal Farm Loan Board pursuant to Section 29 of said Federal Farm Loan Act) the aforesaid bonds and appurtenant coupons issued by said Bank and received from said Receiver in exchange therefor liquidating dividends totalling $580,636.69. At the time your petitioner surrendered said bonds, there was due on said bonds in accrued unpaid interest the sum of $183,352.77. Said sum of $580,636.69 was paid pursuant to the covenants contained in said bonds and in accordance with resolutions adopted by the Federal Farm Loan Board on June 24, 1931, and November 20, 1931; in accordance with said resolutions, said sum was prorated by said Bank and received by your petitioner in the amount of $483,864.69, or approximately 83.4% thereof, as principal, and $96,772.00, or approximately 16.6% thereof, as interest.

IV. Prior to 1931, your petitioner purchased bonds with appurtenant accrued and unaccrued interest coupons issued under the provisions of the aforesaid Federal Farm Loan Act of 1916 by the Bankers Joint Stock Land Bank of Milwaukee, (a Corporation organized under the provisions of said Federal Farm Loan Act) in the principal aggregate amount of $90,000.00 for the sum of $19,335.00. In 1931, petitioner sold said bonds and appurtenant coupons of the Bankers Joint Stock Land Bank of

Milwaukee for the sum of $27,250.00. At the time of the sale, there was due on said bonds accrued unpaid interest the sum of $16,645.83.

V. The bonds referred to in paragraphs III and IV hereof recited upon their face the exemption expressed in Section 26 of the Federal Farm Loan Act in words and figures as follows, to-wit:

> "This bond is issued under the authority of the Act of Congress approved July 17, 1916, which provides that farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, Municipal and local taxation." [2]

VI. The Defendant has, since the enactment of the said Farm Loan Act, at all times, through duly authorized representatives, held out and represented to petitioner and others, by letter, statement, circular and advertisement, that bonds issued by Joint Stock Land Banks under the provisions of said Act were and are exempt from all forms of taxation, and that income derived therefrom through the sale, conversion, or surrender thereof, was and is exempt from federal income taxation, with the intention and expectation that your petitioner and others would rely and act upon such representation, and would be induced thereby to further the purpose and intent of said Act by purchasing said bonds. Your petitioner had knowledge of and relied upon said representations of the defendant when he purchased said bonds of the Kansas City Joint Stock

Land Bank and of the Bankers Joint Stock Land Bank of Milwaukee, and subsequently surrendered or sold said bonds as set out above, and except that petitioner believed the defendant's representations to be true and to represent defendant's policy, he would not have purchased said bonds, as he did in reliance on said representations.

VII. Prior to March 8, 1932, your petitioner requested a ruling from the Commissioner of Internal Revenue to the effect that the income derived from said Land Bank Bonds aforesaid, was not taxable; but on or about March 8, 1932, was advised by the Deputy Commissioner of Internal Revenue that said income would be held taxable. Thereafter and within the time required by law, your petitioner filed with the Collector of Internal Revenue for the First Collection District of California, in form as provided by the Commissioner of Internal Revenue, a return of his income for 1931, and therein listed, separate and apart, the income derived from the said Land Bank Bonds as aforesaid, to-wit, the sum of $84,275.95, being the difference between the price paid for the aforesaid bonds and that received by him on the surrender and sale thereof; that he attached to said petition as a part thereof a protest in writing protesting the ruling of the Deputy Commissioner in holding said income to be taxable, and asserted that the same was exempt from taxation under the provision of Section 26 of the Farm Loan Act of 1916. A copy of the protest so

attached to said return aforesaid, is attached hereto and made a part hereof [3] as "Exhibit A".

VIII. Subsequent to the filing of your petitioner's return as aforesaid, and on or about November 13, 1933, the Internal Revenue Agent in Charge at San Francisco served on your petitioner a notice of a proposed deficiency tax based on said return and upon asserted errors therein other than that pertaining to taxation of income derived from said Farm Loan Bonds, the proposed deficiency being the sum of $3424.20; thereafter and on or about December 4, 1933, your petitioner filed a protest with said agent and a conference was held thereon on or about February 5, 1934. As a result of said conference an agreement was entered into covering all issues discussed at said conference and fixing a deficiency at $3286.34; but said agreement did not cover the issue of taxability of income derived from Federal Farm Loan Bonds, which issue was not discussed and was not agreed upon.

But for the wrongful and unlawful inclusion as taxable income for said year of the income derived from Joint Stock Land Bank bonds aforesaid in the sum of $84,275.95, your petitioner would have had no taxable income for the year 1934, even under the adjustment proposed and made as a result of the conference of February 4, 1934.

Nevertheless, and notwithstanding the fact that your petitioner had no taxable income for said year, and notwithstanding the provisions of Section

26 of the Farm Loan Act and of the covenants of said Farm Loan Bonds, and notwithstanding the representations made by the authorized agents of the United States, the Commissioner of Internal Revenue of the United States did wrongfully, erroneously and unlawfully assess, and the Collector of Internal Revenue of the United States did give notice and demand requiring your petitioner to pay, and your petitioner did pay, income tax for the year 1931 upon income derived from said bonds as aforesaid, in the amount of $4276.19, said payments being made at the following times and in the following amounts:

March	15, 1932	$ 140.16
April	15, 1932	28.32
June	15, 1932	140.16
September	15, 1932	140.16
December	15, 1932	140.21
April	16, 1934	3,687.18
Total		$4,276.19

[4]

No petition has been filed by your petitioner with the Board of Tax Appeals for redetermination or review of the deficiencies or taxes assessed against your petitioner with respect to the year 1931.

IX. Thereafter and on or about the 16th day of May, 1934, your petitioner prepared and caused to be filed with the Collector of Internal Revenue for the First Collection District of California, a duly executed claim for the refund of said income tax so erroneously assessed and collected as aforesaid, said claim being for the principal sum of

$4,107.76 (the amount paid on and after June 15, 1932). A copy of said claim as filed is attached hereto and made a part hereof, marked "Exhibit B".

X. On or about June 28, 1935, an additional statement of fact amending said claim was filed with the Bureau of Internal Revenue at San Francisco, together with a memorandum of points and authorities in support thereof. The additional statement of fact was as follows:

"Both the Kansas City Joint Stock Land Bank and the Banker's Joint Stock Land Bank, with whose bonds we are concerned, were in receivership and in process of liquidation at the time of the disposal by the taxpayer of the bonds involved herein.

"The refund in the amount of $4107.76 is claimed on the grounds:

(a) That in the return filed by the taxpayer, tax exempt income on the liquidation of the Kansas City Joint Stock Land Bank bonds were included in his taxable income for the year 1931.

(b) That in the return filed by the taxpayer, tax exempt income on the sale of Bankers' Joint Stock Land Bank bonds were included in his taxable income for the year 1931.

"During the year 1930 the taxpayer acquired bonds of the Kansas City Joint Stock Land Bank in the aggregate principal amount of $886,000.00, at a cost to him of $504,275.74. This bank, in re-

ceivership since May 4, 1927, was in process of liquidation in 1931. On June 24, 1931, the Federal Farm Loan Board authorized a liquidating dividend on all outstanding bonds of the bank aggregating $26,750,000.00; on November 20, 1931, an additional $300,128.26 was authorized. The amount of liquidating dividends received by this taxpayer was $580,636.69. [5]

"In addition to the principal par value of the bonds held by him ($886,000.00) the unpaid accrued interest at the time of the surrender of the bonds was $183,352.77; so that the total amount due on the face of the bonds and coupons was $1,069,352.77. While, therefore, the taxpayer had an income of $76,360.95 on the transaction, that being the difference between his purchase price and the amount received by him in liquidation, nevertheless the amount so received by him was less than the full amount due by some $488,716.08; and the income actually received by him was less than the interest actually due by $106,991.82.

"During the year 1930, the taxpayer also acquired bonds of the Bankers' Joint Stock Land Bank of Milwaukee in the aggregate principal amount of $90,000,00, at a cost to him of $19,335.00. At the time he sold these bonds in 1931 there was due in interest accrued thereon the sum of $16,645.83, making a total due, principal and interest of $106,645.83. He sold the bonds in 1931 for the aggregate sum of $27,250.00. While, therefore, in this case the taxpayer also had an income of $7,915.00 on the

transaction, the difference between his purchase price and the sale price, nevertheless the amount so received by him was less than the full amount due by $78,395.83, and the income actually received by him was less than the interest actually due by $8730.83."

XI. After the protest mentioned in paragraph IX had been filed by your petitioner, and as a preliminary to a ruling thereon, an examination of the books of your petitioner was made by a representative of the Internal Revenue Agent in Charge at San Francisco; and based on said examination a report to the Commissioner of Internal Revenue was duly made on or about October 26, 1934, which report recommended the elimination from net income of the income derived by petitioner from said bonds, as aforesaid, and the refund to your petitioner of the tax paid within two years prior to filing the claim, to-wit, the sum of $3706.92.

XII. That nevertheless, on or about the 9th day of June, 1937, the Commissioner of Internal Revenue mailed to your petitioner by registered mail a notice of the disallowance of said claim; a copy of said notice is [6] attached hereto and made a part hereof, marked "Exhibit C". This suit is brought within two years from the date of mailing said notice of disallowance (Sec. 1672-1673 U. S. C.).

XIII. The entire sum paid to your petitioner by the Receiver of the Kansas City Joint Stock Land Bank for the surrender of the bonds of said bank to said Receiver, including that portion of said sum

which exceeded the cost thereof, was paid under and pursuant to the covenants contained in said bonds, and was, and is, exempt from any and all forms of taxation under the provisions of Section 26 of the Federal Farm Loan Act. The income derived by your petitioner from the aforesaid bonds of the Kansas City Joint Stock Land Bank as set forth in Paragraph III supra, was, and is, income derived from said bonds within the meaning and provisions of the said Section 26 of the said Federal Farm Loan Act, and by virtue of said section was, and is, exempt from the imposition of any income tax. The imposition of a tax on said income is a violation of the covenants contained in said bonds and of the representations made by the duly authorized agents of the defendants to the general public and to this petitioner in the sale of said bonds; and contravenes the Fifth Amendment to the Constitution of the United States.

XIV. The income derived by your petitioner from the aforesaid bonds of the Bankers' Joint Stock Land Bank as set forth in Paragraph IV supra was, and is, income derived from said bonds within the meaning and provisions of Section 26 of the Federal Farm Loan Act, and by virtue thereof was, and is, exempt from the imposition of any income tax. The imposition of a tax on said income is a violation of the covenants contained in said bonds, and of the representations made by the duly authorized agents of the United States to the general public and to your petitioner in a sale of said

bonds; and contravenes the Fifth Amendment to the Constitution of the United States.

Wherefore, your petitioner prays that a judgment may be made and entered herein, adjudging that the income derived by your petitioner from the bonds of the Kansas City Joint Stock Land Bank, through their purchase and surrender to the Receiver of said bank, and from bonds of the Bankers Joint Stock Land Bank of Milwaukee through their purchase and sale, [7] is exempt from taxation by virtue of the provisions of Section 26 of the Federal Farm Loan Act and related statutes; that taxation of such income would be and is contrary to the covenants contained in said bonds and to the representations of the Treasury Department of the United States and in violation of the Fifth Amendment to the Constitution of the United States; that plaintiff herein have and recover judgment against the defendant in the sum of $4,107.76, together with interest thereon from the various dates on which the respective payments were made as provided by law, and his costs herein, and for such other and further relief as to the Court may seem proper.

Dated this 31st day of December, 1937.

W. G. HARMON,
ERNEST L. WILKINSON,
WALTER G. MOYLE,
J. EDWARD JOHNSON,
Attorneys for Petitioner,
206 Sansome Street,
San Francisco, Cal.

State of California
City and County of San Francisco—ss.

Ashby Oliver Stewart, being first duly sworn deposes and says:

That he is the petitioner named in the foregoing petition; that he has read the same and knows the contents thereof, and that the same is true of his own knowledge except as to the matters therein stated on information and belief, and as to those matters, that he believes it to be true.

ASHBY OLIVER STEWART.

Subscribed and sworn to before me this 4th day of January, 1938.

[Seal] DAISY CROTHERS WILSON,
Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Aug. 14, 1941. [8]

"EXHIBIT A"

Honorable Commissioner of Internal Revenue,
Washington, D. C.

Dear Sir:

The 1931 Income Tax Return of the undersigned, A. O. Stewart, 400 Sansome Street, San Francisco, California, to which this letter is attached and forms a part of said return, has among other schedules and exhibits one captioned Schedule "C". This

Schedule "C" covers the results from the sale of real estate, stocks and bonds, shown on Page 1 of the return as Item 8.

You will note that the last four items on this Schedule "C" are preceded by a statement, making reference to telegraphic decision of the Honorable Deputy Commissioner, J. C. Wilmer, dated March 8, 1932, and that while this decision has been followed by me by including these items as taxable income, the same has been returned as taxable income under protest. The contention is that none of the last four items on this schedule are taxable income and I quote for your consideration the following authorities:

Title 12, Section 931 of the United States Code, with reference to Banks and Banking and dealing with exemption from taxation:

> ". . . First mortgages executed to Federal land banks, or to joint-stock land banks, and farm loan bonds issued under the provisions of this chapter, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation. (July 17, 1916, c. 245, Par. 26, 39 Stat. 380.)"

1st: You will note from the above that it was the intention of the Federal Farm Loan Act to exempt all INCOME derived from these securities.

2nd: Section 22, Par. 7102, of the 1928 Act defines Gross Income, as follows:

> "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

There are various decisions which have been handed down from time to time, many of them being Supreme Court decisions, which have held that trading in stocks and bonds of any nature constitutes either profit or loss in the transaction. The language of the Federal Farm Loan Act is very clear as well as the Amendment of 1923 which includes Federal intermediate banks. Also the definition of Income is very clear, and I cannot see where the authority is for the decision that the income derived from these bonds is taxable, [9]

It is for this reason that I respectfully protest the inclusion of the amount of $84,275.95 profit made on these bond transactions as taxable income, and I will follow this return by a claim in abate-

ment or a claim for refund for the taxes paid on these items.

Very truly yours,

Agent for A. O. Stewart.

GTM:M [10]

"EXHIBIT B"

Form 843
Treasury Department
Internal Revenue Service
Revised June, 1930

Claim

To Be Filed with the Collector where Assessment was Made or Tax Paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Collector's Stamp (date received).

Refund on Tax Illegally Collected.

Refund of Amount Paid for Stamps unused, or used, in Error or Excess.

Abatement of Tax Assessed (not applicable to estate or income taxes.)

State of California
City and County of San Francisco—ss.

Name of Taxpayer or purchaser of stamps, A. O. Stewart.

Business address, 400 Sansome St.. San Francisco, California.

Residence, #1 18th Avenue, San Francisco, California.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed, First District of California.

2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1931, to Dec. 31, 1931.

3. Character of assessment or tax, Income Tax, 1931.

4. Amount of assessment, $4276.19**; dates of payment, 3/15-4/30-6/15-9/15-12/15/32 and

5. Date stamps were purchased from the Government, 4/16/34.

6. Amount to be refunded, $4107.76.

7. Amount to be abated (not applicable to income or estate taxes) $.....

8. The time within which this claim may be legally filed expires, under Section 322 (a) (b) of the Revenue Act of 1932, on June 15, 1934.

The deponent verily believes that this claim should be allowed for the following reasons:

**Original Assessment	589.01
Deficiency "	3286.34
	3875.35
Interest	400.84
	4276.19

Tax Exempt Income in the sum of $84,275.95, divided equally between the taxpayer and Mary E. Stewart (his wife), was erroneously included as Taxable Income in return as filed for the calendar year 1931. Examining Agent, March 2, 1934, failed to pick up this amount and make necessary adjustment therefor.

The tax exempt income in question is detailed on Schedule "C", Profits and Losses on Sales of Real Estate, Stocks and Bonds, attached to said return and of which a copy is hereto attached for ready reference. [11]

This tax exempt income is shown in said Schedule "C" as profits on the liquidation of Kansas City Joint Stock Land Bank bonds and sale of Bankers Joint Stock Land Bank bonds, as follows:

Proceeds from	$886,000	par value	K.C.J.S.L.B.	Bonds			580636.69
Cost of	886,000	"	"	"	"		504275.74
Profit on	886,000	"	"	"	"		76360.95
Sale of	90,000	"	"	B.J.S.L.B.	"	27250.00	
Cost "	90,000	"	"	"		19335.00	
Profits on	90,000	"	"	"			7915.00
							84275.95
50% included in taxpayer's return							42137.98

Section 26 of the Federal Farm Loan Act, July 17, 1916, as amended provides in part as follows:

> "First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds, issued under the provisions of this

Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

The income covered by this claim is therefore tax exempt in accordance with this statute. In support of this, the taxpayer respectfully refers to the opinion handed down on April 3, 1933, in a communication from the Honorable C. M. Charest, General Counsel for the Bureau of Internal Revenue, addressed to the Honorable Deputy Commissioner J. C. Wilmer (Reference CC:1:STH in Re: Des Moines Joint Stock Land Bank, Des Moines, Iowa) in which reference is made to memorandum (IT:AR:D-4 JWH) dated July, 1932, addressed to his office. In this communication the opinion is that this income constitutes "exempt income" and, therefore, is non-taxable.

For computations of net income, taxes paid, and refund claimed, see Schedule 1-Block Adjustments, attached, also copy of Schedule "C", as attached to the original return, showing the computations of the income on the above transactions.

Signed A. O. STEWART

Sworn to and subscribed before me this 16th day of May, 1934.

DAISY CROTHERS WILSON,
Notary Public in and for the City and County of San Francisco, State of California. [12]

SCHEDULE 1—BLOCK ADJUSTMENT

Line	Income	Original Return	Examiner's Adjustments 3/2/34 Additions	Examiner's Adjustments 3/2/34 Deductions	As Adjusted by Examiner	Taxpayer's Claim for Adjustment to Examiner's Report Deductions	As Adjusted by Taxpayer
1	Salaries	3,232.20			3,232.20		3,232.20
3	Interest	45,719.02		600.00	45,119.02		45,119.02
4	" T.F.C. Bonds	19,067.69		125.00	18,942.69		18,942.69
8	Profits on Sales	25,651.90*	3,505.29		22,146.61*	84,275.95	106,422.56*
10	Dividends	62,755.48	400.00		63,155.48		63,155.48
11	Other Income	113,500.91		8,010.69	105,490.22		105,490.22
12	Total Income	218,623.40	3,905.29	8,735.69	213,793.00	84,275.95	129,517.05
	Deductions						
13	Interest Paid	133,016.39			133,016.39		133,016.39
14	Taxes Paid	1,067.61			1067.61		1,067.61
17	Contributions	550.00			550.00		550.00
18	Other Deductions	21,730.37	5,165.49	491.75	17,956.63		17,056.63
	Total Deductions	156,364.37	5,165.49	491.75	151,690.63		151,690.63
	Net Income	62,259.03	9,070.78	9,227.44	62,102.37		22,173.58*
	½—Mary W. Stewart	31,129.52			31,051.19		11,086.79*
	½—A. O. Stewart	31,129.51			31,051.18		11,086.79*
	½ of Cap. Net Loss $102,947.58 added back	—	51,473.79		51,473.79		51,473.79
		31,129.51			82,524.97		40,387.00
	Computation of Tax						
	Income Subject to Tax	31,129.51			82,524.97		40,387.00
	Less Dividends 31,377.74			31,577.74		31,577.74	
	Exemption 1,750.00	33,127.74		1,750.00	33,327.74	1.750.00	33,327.74
	Subject to Normal Tax	None			49,197.23		7,059.26
	Normal Tax at 1½%	—		4,000.00	60.00	4,000.00	60.00
	" " at 3%	—		4,000.00	120.00	3,059.26	91.78
	" " " 5%	—		41,197.23	2,059.86	—	—
	Surtax 31,129.52	970.36		82,524.97	8,339.74	40,387.00	1,852.57
	Total Tax	970.36			10,579.60		1,914.35
	Less 12½% on Cap. Net Loss	—		6,434.22		6,434.22	
	Credit 25% for Earned Net Income			80.60		80.60	
	Tax Paid at Source	381.35		189.43	6,704.25	189.43	6,704.25
	Tax Assessed	589.01			3,875.35		None
	Paid 3/15-6/15-9/15-12/15/32				589.01		589.01
					3,286.34		
	Interest to 4/15/34				400.84		
	Paid 4/16/34				3,687.18		3,687.18
	Total Payment to Date						4,276.19
	Payment 3/15/32 against which Statute of Limitation has run					140.16	
	" 4/1/32 " " " " " " "					28.27	168.43
	Claim for Refund						4,107.76

SCHEDULE "C"

PROFITS AND LOSSES ON SALES OF REAL ESTATE, STOCKS AND BONDS

		Cost	Sale	Profit	Loss	Net
	Tax Free Covenant Bonds:					
2,000	Amer. Toll Bridge Co. 8s	$ 2,005.00	$ 2,000.00	$ —	$ 5.00	
4,000	Richfield Oil Co.	3,950.00	688.00	—	3,262.00	3,267.00•
	Tax Exempt Bonds:					
15,000	Montecito Water 5s	15,000.00	15,482.85	482.85	—	
5,000	State of Oregon Vet.	4,987.50	5,062.50	75.00	—	
10,000	Santa Cruz Water	10,188.10	10,237.50	49.40	—	
10,000	Los Angeles Water 4½s	10,051.29	9,937.50	—	113.79	
10,000	Marin Mun. Water Dist.	10,201.68	10,400.00	198.32	—	
10,000	City of Knoxville, Tenn.	11,420.00	8,975.00	—	2,445.00	
10,000	City of San Antonio, Tex.	9,747.72	9,050.00	—	697.72	
10,000	City of San Francisco Water	10,074.26	10,000.00	—	74.26	2,525.20•
	Other Bonds:					
5,000	Kingdom of Italy	4,862.50	4,653.59	—	208.91	
3,000	Assoc. Oil Co.	3,000.00	3,082.50	82.50	—	
12,000	Union Ice Co.	11,950.00	12,023.69	73.69	—	52.72•
	Stocks:					
3,000	Transamerica	134,208.90	5,765.00	—	—	128,433.90•
80	So. Pac. Golden Gate "B"	1,530.32	759.09	—	—	771.23•
10	Sonoma Properties Co.	2,500.00	—	Bankrupt—no recovery.		2,500.00•
	Miscellaneous Stocks:					
	Rights of Pac. Mut. Life Ins.	—	1.30	1.30		
25	Chase National Bank	Stock Div.	2,585.05	2,585.05	—	
100	Blue Ridge Preferred	5,150.00	3,778.00	—	1,372.00	
400	Shenandoah	12,837.50	13,312.00	474.50	—	
75	Blue Ridge Preferred	3,862.50	2,829.73	—	1,032.77	
100	So. Calif. Gas Pf.	9,875.00	9,373.00	—	502.00	154.08
	Real Estate					
	Installments—Chips Is. Sales Contracts Receivable	Total Receipts Total costs these lands	11,959.78	—	—	11,959.78
	" Van Sickle Is. Sales contracts receivable	recovered in 1929	15,508.34	—	—	15,508.34
						109,927.85•
19,000	Kansas City Joint Stock Land Bank Bonds	9,265.00	10,947.95	1,682.95	—	1,682.95
420,000	" " " "	243,423.48	297,904.05	54,480.57	—	54,480.57
447,000	" " " "	251,587.26	271,784.69	20,197.43	—	20,197.43
90,000	Bankers Joint Stock Land Bank Bonds	19,335.00	27,250.00	7,915.00	—	7,915.00
		Net Loss Item 8				$25,651.90•

•Indicates red figures.

"EXHIBIT C"

Treasury Department
Washington

Jun-9 1937

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
And Refer To
IT:E:1
BAG

Mr. A. O. Stewart,
400 Sansome Street,
San Francisco, California.

Sir:

Further reference is made to your claim for refund in the amount of $4,107.76 income taxes for the taxable year ended December 31, 1931.

The basis of the claim is that tax exempt income on the liquidation of the Kansas City Joint Stock Land Bank bonds and the sale of Bankers Joint Stock Land Bank bonds was included in your taxable income and should be eliminated as nontaxable.

The claim has been carefully considered in connection with information furnished in your protests and at a conference held in this office on September 16, 1936. As stated in office letter to you dated May 10, 1935, the Bureau holds that because a Joint Stock Land Bank is exempt from tax upon the in-

come resulting from a purchase of its own bonds, it does not follow that the profit realized by an individual from a sale of such bonds is not taxable. While the bonds and the income therefrom are by the Farm Loan Act (39 Stat. 360, amended, 41 Stat. 1454) declared nontaxable, being deemed instrumentalities of the United States, the individual owners of such bonds are not Federal agencies (see Smith v. Kansas City Title and Trust Co. et al., 255 U. S. 180), and with respect to the profits upon the sales of the bonds they stand upon the same footing as a seller of state bonds, the interest on which is exempt. (See Wilcutts v. Bunn, 282 U. S. 216, Cumulative Bulletin X-1, page 309 (year 1931)).

It was contended that liquidating dividends received by you from the receiver of the bank in exchange for the bonds were prorated between principal and accrued interest in the proportions of 83.4 percent and 16.6 percent, respectively. This matter was referred for consideration to the internal revenue agent in charge at San Francisco, California, and the accrued interest on the bonds at the date of purchase could not be accurately determined from your books and records.

Accordingly, no change has been made from the previous holding of the Bureau that the profit from the sale of bonds is taxable.

For the foregoing reasons the disallowance of your claim has been sustained. Official notice of the disallowance will be issued by registered mail in

accordance with section 1103 (a) of the Revenue Act of 1932.

A copy of this letter has been mailed to your representative, Mr. Walter G. Moyle, Earle Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Respectfully,
CHAS. T. RUSSELL,
Deputy Commissioner.
By F. L. HUDSON,
Head of Division.

Due Service by copy hereof made this 5th day of January, 1938.

FRANK J. HENNESSY,
United States Attorney.
By ESTHER B. PHILLIPS,
Assistant United States Attorney.

[Endorsed]: Filed Jan. 5, 1938. [15]

[Title of District Court and Cause.]

ANSWER

Now comes the defendant by its Attorney, Frank J. Hennessy, United States Attorney for the Northern District of California, and answers the complaint herein as follows:

I.

Defendant admits the allegations of Paragraph I of the complaint.

II.

Answering the allegations of Paragraph II of the complaint, defendant denies that the taxes referred to were erroneously or unlawfully assessed against the plaintiff, or were erroneously or unlawfully collected from the plaintiff. [16]

III.

Defendant has no information or belief upon the allegations of Paragraph III of the complaint, and because of its lack of information and belief, defendant denies each and every allegation in said paragraph.

IV.

Defendant has no information or belief upon the allegations of Paragraph IV of the complaint and because of its lack of information and belief, defendant denies each and every allegation in said paragraph.

V.

Defendant admits the allegations of Paragraph V of the complaint.

VI.

Defendant denies each and every allegation of Paragraph VI of the complaint.

VII.

Answering the allegations of Paragraph VII of the complaint, defendant has no information or belief on the allegation that the income derived by plaintiff from the bonds referred to in said para-

graph was $84,275.95, but admits that he filed a return in which said item of income was reported in the manner alleged in said paragraph. Admits the remaining allegations in Paragraph VII.

VIII.

Answering the allegations of Paragraph VIII of the complaint, defendant denies that the defendant in taxing the plaintiff for his income tax for the year 1931 acted wrongfully or unlawfully in any respect, or that the defendant taxed plaintiff on amounts as taxable income for said year which should not have been included.

Defendant admits the allegations of the first Paragraph of Paragraph VIII of the complaint beginning with line 2 to line 14, inclusive, (page 4). Defendant denies the allegations of the second Paragraph of Paragraph VIII of the complaint beginning with line 14, to line 18, inclusive (page 4).

Defendant admits that the plaintiff paid income taxes for the year 1931 upon the dates and in the amounts alleged in said paragraph, pursuant to an assessment of the defendant's Commissioner of Internal Revenue, and [17] pursuant to the notice and demand from the defendant's Collector of Internal Revenue.

Defendant admits that plaintiff has not filed petition with the Board of Tax Appeals for redetermination or review of the deficiencies assessed against plaintiff for the year 1931.

Saving for these express admissions, defendan denies the remaining allegations in Paragrapl VIII.

IX.

Answering the allegations of Paragraph IX o the complaint, defendant denies that income taxe for the year 1931 were erroneously assessed or col lected from the plaintiff.

Defendant admits the remaining allegations o Paragraph IX of the complaint.

X.

Answering the allegations of Paragraph X, de fendant admits that on or about June 28, 1935, purported amended claim was filed with the Bureau of Internal Revenue at San Francisco in the form set up in said Paragraph. Defendant denies tha said amended claim so filed was meritorious.

XI.

Answering the allegations of Paragraph XI o the complaint, defendant admits the allegations o said paragraph

Defendant denies that the report referred to i said paragraph, was a final determination or wa in any way binding upon the defendant.

XII.

Defendant admits the allegations of Paragrap XII of the complaint.

XIII.

Answering paragraph XIII of the complaint, defendant denies each and every allegation contained in said paragraph.

XIV.

Defendant denies each and every allegation of Paragraph XIV.

Wherefore Defendant prays that the complaint be dismissed, for its costs, and for such other relief as may be just.

FRANK J. HENNESSY,
United States Attorney.
ESTHER B. PHILLIPS,
Assistant United States Attorney.

[18]

United States of America,
Northern District of California—ss.

Esther B. Phillips, being first duly sworn, deposes and says:

I hold the Office of Assistant United States Attorney for the Northern District of California. I make this verification in my official capacity in behalf of the defendant, the United States of America, because the defendant is a sovereign state. I have read the foregoing answer and know its contents. It is true of my own knowledge save as to the matters therein alleged on information and belief, and as to those matters I believe it to be true.

ESTHER B. PHILLIPS.

Subscribed and sworn to before me this 4th da
of April, 1938.

[Seal] B. E. O'HARA,
Deputy Clerk, U. S. District Court, Northern Di
trict of California.

Service of the within answer by copy admitte
this 4th day of April, 1938.

W. G. HARMON,
Attorney for Plainti

[Endorsed]: Filed Apr. 5, 1938. [19]

[Title of District Court and Cause—20379-S.]

STIPULATION

It is hereby stipulated and agreed by and betwe
the parties hereto, by their respective counsel
record, that in addition to the facts alleged a
admitted to be true in the pleadings on file here
the following facts may also be considered as tr
without further proof, subject to the rights of eith
party to object on the grounds of materiality a
relevancy, and to the right of either party to int
duce further evidence not inconsistent herewith:

I.

Prior to the year 1931 petitioner for himself a
wife purchased bonds with appurtenant accrued a
unaccrued interest coupons, issued under the pro
sions of the Federal Farm Loan Act of 1916 by t
Kansas City Joint [20] Stock Land Bank, a corp

ration organized under the provisions of the Federal Farm Loan Act, in the aggregate principal amount of $886,000.00 (par value), paying therefor the purchase price of $504,275.74. In 1931 petitioner for himself and wife surrendered to the receiver of said Kansas City Joint Stock Land Bank (who was duly appointed as such receiver by the Federal Farm Loan Board pursuant to section 29 of the Federal Farm Loan Act) the aforesaid bonds and appurtenant coupons, and received from said receiver in exchange therefor the sum of $580,636.69, all of which was paid to petitioner and his wife under and pursuant to the covenants contained in said bonds.

II.

Prior to 1931 petitioner for himself and wife purchased bonds and appurtenant accrued and unaccrued interest coupons, issued under the provisions of the Federal Farm Loan Act of 1916 by the Bankers Joint Stock Land Bank of Milwaukee, a corporation organized under the provisions of the Federal Farm Loan Act, in the principal aggregate amount of $90,000.00 (par value, paying therefor the sum of $19,335.00. In 1931 petitioner for himself and wife sold said bonds and appurtenant coupons for the sum of $27,250.00.

III.

The total amount received by petitioner and his wife from the bonds surrendered to the receiver of the Kansas City Joint Stock Land Bank exceeded the total amount paid therefor by $76,360.95; the

total amount received by petitioner and his wife upon the sale of the bonds of the Bankers Joint Stock Land Bank exceeded the amount paid therefor by $7,915.00. It is the taxability to petitioner of one-half the sum total of these gains which is the matter in issue in this case.

IV.

In making his income tax return for the year 1931, the year in question, petitioner divided his income between himself and his wife pursuant to the community property law of the State of California; and petitioner and his wife filed identical separate returns. Petitioner managed all business dealings for the marital community. Petitioner was on a cash basis and [21] rendered his return for the year 1931 on that basis.

V.

A typical bond of the Kansas City Joint Stock Land Bank reads as follows:

"Joint Stock Farm Loan Bond
Act of Congress Approved July 17, 1916
And Amendments Thereto

$1,000 M182673 $1,000

The Kansas City Joint Stock Land Bank
of
Kansas City, Missouri
Is Indebted to the Bearer in the Sum of
One Thousand Dollars

This bond is payable thirty years from date of issue with interest at the rate of 5 per centum

per annum, payable semi-annually following date of issue. Both principal and interest are payable in gold or lawful money of the United States at the office of the issuing Joint Stock Land Bank, or at the office of such fiscal agent or agents as such Bank may hereafter designate. This bond is subject to redemption on any interest date after ten years from the date hereof by the payment of the principal of the bond and the unpaid accrued interest.

This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that "farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

This Bank is organized under Section Sixteen of the Federal Farm Loan Act, operates under the provisions thereof and is under Federal supervision.

In Witness Whereof The Kansas City Joint Stock Land Bank of Kansas City has caused this obligation to be signed by its President and attested by its Secretary under its corporate seal, and three interest coupon sheets of twenty coupons each to be attached hereto.

Coupon Bond.
Issued November 1, 1922
Redeemable After November 1, 1932.
Payable November 1, 1952
Interest Payable
May 1 and November 1

M182673

Kansas City, Missouri, Nov. 1, 1922.

WALTER CRAVENS,
President.

Attest:

J. R. HUMPHREY,
Secretary." [22]

All bonds issued under the Federal Farm Loan Act by Joint Stock Land Banks, including the bonds referred to hereinbefore, contain the same language, with appropriate changes to cover the name of issuing bank, date of issue, rate of interest, denomination and date of payment.

Dated this 15th day of July, 1938.

W. G. HARMON,
ERNEST L. WILKINSON,
Attorneys for Petitioner.
FRANK J. HENNESSY,
United States Attorney,
By ESTHER B. PHILLIPS,
Ass't U. S. Atty.,
Attorneys for Defendant.

[Endorsed]: Filed July 19, 1938. [23]

In the Southern Division of the United States District Court for the Northern District of California.

Law 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

Law 20380-S

MARY WOODS STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

W. G. HARMON,
ERNEST L. WILKINSON,
WALTER G. MOYLE,
J. EDWARD JOHNSON,
Attorneys for Petitioners,
206 Sansome Street,
San Francisco, California.

FRANK J. HENNESSY,
United States Attorney,
Attorney for Defendant,
Post Office Building,
San Francisco, California.

OPINION AND ORDER

Petitioners, husband and wife, sue under the provisions of paragraphs 5 and 20 of Sec. 41, Title 28 U. S. C., to recover income taxes paid for the year 1931, claimed to have been erroneously assessed and collected. [24]

During the year 1930 petitioners purchased farm loan bonds issued under the Federal Farm Loan Act of 1916 by two joint stock land banks, a part of which, in the following year, 1931, they surrendered to the receiver of the issuing bank for liquidation, in an amount in excess of what they had paid therefor, and the remainder of which they sold for an amount in excess of the purchasing price. The gains derived from these two transactions, aggregating over $84,000, were held by the Commissioner to constitute taxable income.

The bonds were issued under the Federal Farm Loan Act of 1916, 12 U. S. C. Sec. 931, which, among other matters, provides that farm loan bonds issued by such banks "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." The Revenue Act of 1928 provides that there shall be levied a tax upon all income, including "gains, profits, and income derived from salaries . . . or sales or dealings in property, whether real or personal . . ." It further directs that interest upon securities issued under the provisions of the Federal Farm Loan Act shall be exempt. In 1938 Congress provided in the

Revenue Act of that year, Sec. 817, that notwithstanding the provisions of Sec. 26 of the Federal Farm Loan Act, as to obligations issued after the date of the act, all income from such bonds, except interest, shall be included in gross income.

Prior to the purchase of the bonds in question, the Commissions of Internal Revenue had apparently uniformly held that gains from sales of such obligations was exempt income. The expressions of some of the members of Congress in discussing the bill while its passage was being considered, indicated a like belief upon their part. The evidence is [25] that Mr. Stewart, who acted also for his wife, relied upon these opinions and the language of the Act, and believed that he was purchasing securities the profit upon which, in case of sale, would result in exempt income.

In Willcuts v. Bunn, 282 U. S. 216, the court held that profit derived by an investor in municipal bonds from their sale by him at a higher price than the purchase price, is taxable as income, even though such municipal bonds and the interest therefrom are exempt. The Government relies upon this opinion as decisive of the issue presented in the present case, but it is apparent that the scope of the opinion is not broad enough to constitute an adjudication upon the question immediately confronting us. There the statute made the bond and the "interest therefrom" exempt. Here the statute makes the bond and the "income therefrom" exempt, and petitioners insist that under the express words of the

statute a profit realized from the sale of such securities is income derived from the property itself and therefore exempt. Thus the immediate question is whether the profit derived from the sale of such bonds is income derived from the bonds. Clearly it is not interest or dividends; just as clearly it represents an accretion to the value of capital which has been converted into cash. It is a growth or increment of value in the investment,—an increment of gain accruing to capital. The statute itself recognized this in including gains "derived from sales or dealings in property." Obviously the profit arises from the dealing.

In this connection the language of Chief Justice Hughes in Willcuts v. Bunn, supra, is pertinent. There he said:

> (Page 227-8) "The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an 'income tax' and the profits on sales are included in 'income,' the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. . . . The tax upon interest is levied upon the return which comes to [26] the

owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales in an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.'"

So the income made up of gain from profit realized upon sale of the bonds here involved was the result of the combination of several elements, including capital investment, and quite obviously no small degree of sagacity on the part of Mr. Stewart. In the words of the Chief Justice, the resulting gain is to be regarded as the creation of capital, industry and skill. The situation is not greatly different from that contemplated by state and federal statutes levying taxes upon transfers of estates. Such a tax is proper even though the property transferred is exempt. In the present instance Congress has seen fit to include the taxable income upon the sale of property all realized accretion in value. The fact that the investment has its form of existence in exempt securities does not alter the liability of the holder for a tax upon the profits resulting from the cooperation of various elements, contributing to one final result.

Nor do I believe that the previous administrative announcements of various Commissioners is any bar to the present action by way of estoppel or otherwise. Acquiescence, even a positive undertaking by an officer of the Government, if not authorized by Congress, does not bind the United States when it seeks to enforce a public right or assert a public interest. Wilber National Bank v. United States, 294 U. S. 120; Botany Mills v. United States, 278 U. S. 282. A mistake of law does not constitute ground for an estoppel. Mutual Life Ins. Co. v. Phinney, 178 U. S. 327; Sturm v. Boker, 150 U. S. 312. The Commissioner can not, by his mistake of law, set as naught statutes of United States. Ritter v. United States, 28 Fed.(2d) 265 (C. C. A. 3). [27]

I conclude, therefore, that the tax was properly assessed, and that petitioners' suits must fail. I adopt the foregoing as my findings of fact and conclusions of law.

Judgment will enter against petitioners in bar of their suits and for costs.

Dated: August 20th, 1938.

WALTER C. LINDLEY,
United States District Judge.

[Endorsed]: Filed Aug. 20, 1938. [28]

[Title of District Court and Cause—Nos. 20379-S and 20380-S.]

ORDER AMENDING FINDINGS OF FACT NUNC PRO TUNC

The plaintiffs herein having made and filed a written motion, within term, for the amendment of the Findings of Fact heretofore on August 20, 1938, made and filed herein, a copy of said motion having been served upon the attorneys for defendant; and the attorneys for the respective parties having stipulated that said motion be filed and submitted to the Honorable Walter C. Lindley, Judge of the United States District Court who heard said causes, for his decision thereon in his home district, the Eastern District of [29] Illinois; and the Court having read said motion, and good cause appearing for this order, it is ordered that the Opinion of the Court heretofore filed herein on August 20, 1938, and by the Court adopted as its Findings of Fact and Conclusions of Law be and the same is hereby amended by the addition of the following findings to be added thereto at the places indicated:

The following sentences to be added to paragraph 2:

> "$76.360.95 of this profit came from the bonds surrendered to the receiver of the issuing bank, all of which was paid to petitioners under and pursuant to the covenants contained in the surrendered bonds. Both banks were in receivership at the time petitioners purchased their

bonds, and neither was paying interest; the purchases were made for the prospective increment to the bonds and not for their interest."

The following paragraph to be added to precede paragraph 4:

"From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Loan Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds. These circulars contained statements that the bonds and their income were 'free from all forms of taxation', including 'income tax and all forms of State and municipal tax of every kind and character' (Ex. 1, p. 8); that 'this exemption is complete'; that 'in addition to the exemption from State, city and local taxation the bonds are free from the normal and additional Federal income tax and need not be included in tax returns' (Ex. 2, p. 3); that these bonds were 'exempt from every form of taxation,—Federal, state or local—with the single exception of succession and inheritance taxes' (Ex. 4, p. 1); that people could buy the bonds and 'forget about the taxes on them' (Ex. 4, p. 3). Mr. Stewart, acting for both [30] petitioners, saw and studied these and other circulars, none of which negatived or restricted the language above quoted. He relied upon these statements in making his purchases, reasonably believing

he was purchasing securities the profit upon which in case of sale, would be exempt income."

Dated this 2nd day of September, 1938.

WALTER C. LINDLEY,
Judge of United States District Court.

[Endorsed]: Filed Sept. 6, 1938. [31]

In the Southern Division of the United States District Court for the Northern District of California.

No. 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This cause having come on regularly for trial upon the 19th day of July, 1938, before the Court sitting without a Jury, W. G. Harmon, J. Edward Johnson and Ernest L. Wilkinson, Esquires, appearing as attorneys for plaintiff, and Esther B. Phillips, Assistant United States Attorney, appearing as attorney for defendant, and a stipulation of facts having been filed and evidence on behalf of plain-

tiff having been introduced and closed, and the cause having been submitted to the Court for consideration and decision, and the Court after due deliberation having rendered its decision and ordered that judgment be entered herein in favor of defendant, and for costs:

Now, therefore, by virtue of the law and by reason of the premises aforesaid, it is considered by the Court that plaintiff take nothing by this action, and that defendant go hereof without day, and that said defendant do have and recover of and from said plaintiff its costs herein expended taxed at $29.80.

Judgment entered this 20th day of August, 1938.

WALTER B. MALING,
Clerk. [32]

[Title of District Court and Cause—No. 20379-S Law and Consolidated Case, No. 20380-S Law.]

Hon. Walter C. Lindley, Judge.

TESTIMONY

Appearances:

For the Plaintiffs:
W. G. Harmon, Esq., Ernest L. Wilkinson, Esq., and J. Edward Johnson, Esq.

For the Defendant:
Miss Esther B. Phillips.

Tuesday, July 19, 1938

The Court: Stewart vs. The United States.

Mr. Harmon: If your Honor please, at this time I wish to move the admission for the purpose of this case of Mr. Ernest L. Wilkinson, a member of the Bar of the State of California, the District of Columbia and of the Supreme Court of the United States.

The Court: He may participate in the trial without further formality. [34]

Opening Statement

Mr. Harmon: If the Court please, when this case was originally set for hearing I advised the Court that it would take about two days. Since that time we have made some progress in stipulating to some of the facts, and your Honor will recall that I took it up with your Honor's secretary as to whether an argument should be heard at the conclusion of the case now or whether briefs should first be submitted. If the procedure is followed that was then indicated, and argument is deferred until briefs are submitted, I think we can consummate this trial probably in less than a day.

We believe that it will further expedite the matter if rather a full opening statement is made at this point. It will take me about twenty minutes.

The Court: All right.

Mr. Harmon: But it will be very helpful to facilitate ruling on the testimony.

There are two cases before the Court at this time, those of Mr. and Mrs. Stewart, husband and wife. The cases are identical, the petitioners having filed separate returns under the California Community Property Law for the year in question. May it now be agreed and stipulated that these cases can be consolidated for the purpose of this trial and the evidence be considered as applying to both?

Miss Phillips: So stipulated.

The Court: Very well.

Mr. Harmon: Some of the facts have been admitted by the pleadings and others have been stipulated in a stipulation which I now ask leave to file in behalf of both parties.

The Court: It may be filed.

Mr. Harmon: Briefly these admitted facts are as follows: [35]

Prior to 1931, which is the tax year in question, the petitioners purchased bonds issued under the provisions of the Federal Farm Loan Act of 1916 by the Kansas City Joint Stock Land Bank, a corporation organized under that law, the bonds being of the aggregate par value of $886,000. The petitioners paid therefor the sum of $504,275.74.

The Court: That is in 1931?

Mr. Harmon: That is prior to 1931, if your Honor please. In 1931, the tax year, the Kansas City Bank which issued these bonds was in receivership, and the petitioners surrendered those bonds to the receiver and were given in exchange $580,-

636.69, all of which was paid to them under the covenant of the bonds.

The Court: In cash?

Mr. Harmon: In cash.

Another transaction involved: Prior to 1931 the petitioners purchased bonds issued under the provisions of that same act by the Bankers Joint Stock Land Bank of Milwaukee in the aggregate principal amount of $90,000, paying therefor $19,335. In 1931, the tax year in question, the petitioners sold these bonds on the market for $27,250.

The total amount received by the petitioners from the bonds surrendered to the receiver of the Kansas City Bank exceeded the amount which the petitioners paid therefor by $76,360.95.

The total amount received by the petitioners on the other transaction in excess of what they paid was $7915, or an increment on these two transactions of $84,275.95. And it is the taxability of this sum, one-half to each of the petitioners, which is the issue in these cases.

It will be noted from the pleadings and from the stipulated facts that the difference in the transactions pertaining to the [36] bonds of these two banks is that in the one instance they were surrendered to the receiver of the issuing bank and the money received by the petitioners was paid under the covenant of the bonds; in the other instance the bonds were sold on the open market.

The face of a bond of the Kansas City Bank is copied in the stipulation as a typical example of all

Farm Loan bonds. There are differences, but the differences are not material here. All Farm Loan bonds contain this covenant, among others, and I read from the bond: "This bond is issued under the authority of the act of Congress approved July 17, 1916, which provides that Farm Loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the United States Government and as such they and the net income derived therefrom shall be exempt from Federal, State, municipal and local taxation."

The Court: Hasn't the Supreme Court ever passed on the question of whether the profit realized in a sale of such instruments is taxable?

Mr. Harmon: It has not under this particular statute, if your Honor please. It has ruled on this statute incidentally, but this question has never been raised in exactly this way.

The Court: A new question.

Mr. Harmon: Yes, your Honor, it is new.

Before making and filing their income tax return for the year 1931 the petitioners requested a ruling from the Commissioner of Internal Revenue to the effect that this income was not taxable. About March 8, 1932, the Commissioner ruled that the income was taxable. Whereupon, within the time required by law, the returns were duly filed with the Collector, and listed in those returns [37] was this income separate and apart from other income. At the same time they filed a protest against the ruling of the Deputy Commissioner in holding the income

taxable and inserted that the same was exempt under the provisions of Section 26 of the Farm Loan Act. The tax was duly paid in accordance with the rulings of the Commissioner and a claim was filed on May 16, 1934, asking for a refund of $4,107.76 in behalf of each taxpayer, which was the amount they had paid, within the two year period. In due course following the filing of the claim, the internal revenue agent in charge in San Francisco caused an examination of the books of the petitioners to be made, and based on that examination he made a report recommending a refund; but that recommendation was denied on June 9, 1937, whereupon these suits for refund were commenced, claiming that this money had been erroneously corrected.

At this point may I also say that it is stipulated between the parties that if the petitioners are right in their contention that this income is not taxable, each petitioner is entitled to a refund of $4,107.76, plus interest.

Miss Phillips: There is no difference between us as to the amount, your Honor; the question is one of statutory interpretation.

Mr. Harmon: We come now, then, to the principal issue in these cases. Simply stated that is: Is income derived from Farm Loan bonds, in the one instance through their surrender to the receiver of the issuing bank, and in the other instance through their sale on the market, exempt from Federal Income tax by virtue of the provisions of Sec-

tion 26 of the Farm Loan Act? It is our contention that it is exempt. [38]

Our reasons are: First, the provisions of Section 26 of the Farm Loan Act are clear and wholly lacking in ambiguity. According to their plain intent the phrase "income derived therefrom" includes capital gains derived from the bonds. That section reads as follows:

"That every federal land bank and every national farm loan association, including the capital and reserve and/or surplus therein and the income derived therefrom, shall be exempt from federal, state, municipal and local taxation, except taxes upon real estate held, purchased or taken by said bank or association under the provisions of Sections 11 and 13 of this act."

The next sentence is the particular one: "First mortgages executed to federal land banks, to joint stock land banks, and farm loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from federal, state, municipal and local taxation."

The word "income" at and long prior to the enactment of that statute had a well defined meaning in the minds of the investing public, in the opinions of the courts and in the enactments of the legislative branch of the government. One of the most common forms of income known consisted

of capital gains, the difference between the purchase and sales price of property.

Likewise the words "derived therefrom" had a well understood meaning.

It will be our contention that this phrase was invariably used by the Legislature and the courts to denote the capital from which any gain or income sprang, either by way of interest [39] or by way of increment or capital gain. This being true, we shall assert that it follows that, in the absence of any restrictive language in the statute, the words would certainly have such meaning.

We shall take the position that, since Congress has, by its plain language, declared the income in this case to be exempt, it is an infringement upon the prerogatives of Congress for the executive branch, simply because it needs revenue, to assert the tax here in question, and for a court to uphold the executive branch in such an attempt would be none other than judicial legislation. Congress having by express language declared the income to be exempt, we shall contend that it is not for the Treasury Department nor for this court to question the wisdom thereof and to achieve an opposite result by rewriting the statute.

If we are right in this contention that the statute is clear, there will be no need for going further; but in disallowing the claims filed, the Commissioner of Internal Revenue seeks to cast a doubt upon the meaning of the statutory language, particularly on that word "income". The theory on which he does

this is set forth in an unpublished ruling of the Assistant General Counsel of the Bureau of Internal Revenue dated February 28, 1935, a copy of which we will offer in evidence later on. In this ruling it is admitted that joint stock land banks who have purchased their own bonds and have made a capital gain thereon are not taxable by reason of Section 26 of the Act; but it is asserted in the ruling that it does not follow that a capital gain by an individual on Farm Loan bonds is exempt. The ruling admits that the bonds and the income therefrom are not taxable, since they are deemed [40] instrumentalities of the Government, but it asserts that since individuals who are owners of such bonds are not Federal agencies, they are taxable on the capital gain derived from these same instrumentalities.

It will be our position that there is only one exemption provision in the statute relating to these bonds; that in determining whether the capital gain derived from them is taxable it makes no difference whether the taxpayer be a federal agency or an individual. The assistant General Counsel, on the other hand, has given two distinct interpretations to the use of the words "income derived therefrom", and which interpretation as used in a given instance is made to depend upon the status of the derivee of the income. He says that if a land bank makes——

The Court: I have a suggestion that you do not go into an argument now as to the merits of this

question. You have told me what the issue is. Let us defer our argument about it.

Mr. Harmon: I don't want to bore your Honor with a lengthy argument.

The Court: In an opening statement an argument does not have any place. Counsel merely states what the issue is. You have stated that.

Mr. Harmon: I will hasten, if your Honor please, then, and go through the other points that we have here.

It is our contention that the Government sustain the burden of showing that there is an ambiguity in the language of this statute; and if we go into the legal tests which become pertinent only when there is an ambiguity, that those legal tests will support our interpretation rather than the present position of the Government. I refer to those tests for determining the meaning of a statute. [41]

First, we shall contend that the discriminate care with which the words were used indicates clearly an intention to include capital gains.

We shall take the position also, if your Honor please, that the legislative history of the act shows the intent to exempt capital gains; that that language in Section 26 is as wide and comprehensive an exemption as is possible, and that the early drafts of the section clearly show that Congress had in mind at the time the statute was passed dealings in these bonds and the possibility of profits.

In addition, we will show that there has been no amendment to that act through the years down to

1938, but that in 1938 the last session of the Congress did amend the act and in that amendment clearly recognized our contention to be correct as to what the law is for bonds already issued.

As a third canon, we shall contend that a comparison of this exemption statute with other exemption statutes clearly show our position to be correct, and that there is a grave danger to other exemption statutes where words similar are used if this language is construed to mean what the government claims it means.

It will be our contention that the construction of this act by those charged with its construction supports our position. In this respect we shall offer in evidence a number of bulletins and circulars by the Farm Loan Board, which is charged under the Act with the duty of advertising and popularizing the bonds. And these circulars expressly state on their face an exemption which any layman, any man in the investing public, would construe as we construe it and as the petitioners construed it when they purchased these bonds. [42]

Then, too, in the matter of administrative interpretation, there are certain rulings of the Bureau of Internal Revenue which I shall offer in evidence. One of these is known as the Des Moines opinion in 1933, in which it was ruled that the Des Moines Joint Stock Land Bank was not required to pay taxes upon gains which it had made in the purchase of and the discount of its own bonds.

Incidentally, Mr. Stewart, who is one of the petitioners here, was at that time president of the Des Monies Joint Stock Land Bank. Under that ruling, if your Honor please, which has continued in force down to date, joint stock land banks have made profits in dealing in their own bonds and in bonds of other banks, as we shall show, in excess of a hundred million dollars, all of which has been held non-taxable. As late as 1937, the spring of 1937, closing agreements were made by the Revenue Bureau with various banks upon that theory of the law.

Then, too, in 1933, an act was passed requiring these banks to liquidate. To help them liquidate a ruling was sought as to the status of the tax exemption feature on mortgages which had been issued to the banks. That ruling by the General Counsel of the Treasury Department was circulated to the banks, and by them to the investing public, and these banks, on the strength of that ruling, sold great numbers of their mortgages, many of them at a discount, and represented that that income was exempt since the exemption on mortgages stands from the same language as the exemption on bonds. This is a ruling we think that supports our position.

Then, finally, we shall rely on that 1938 statute passed in the Revenue Act where Congress had before it the Des Moines opinion and accepted it as a correct interpretation of the ex- [43] isting law, and changed the law as to future exemptions so as to exempt only interest, but limited that change,

for obvious constitutional reasons, so that the law prior to 1938 has been to exempt that income.

Then there is one other point, if your Honor please, upon which we will rely. It is that the Government is estopped to collect a tax after having first through its duly authorized agents held out that these securities were tax exempt. To support this we propose to show that the Board originally charged with administering the act under the authority of the statute represented to the public down through the years that the bonds and the income derived therefrom were exempt from tax; that the exemption was complete; that it was from all forms of taxation; that it explicitly exempted the Federal Income Tax; that the validity of the bonds and their exemption as represented had been confirmed by the opinions of the Attorney General an eminent private counsel and by the Supreme Court itself.

We shall show further that the petitioners purchased these bonds as an investment and for the possibility of their increment and not merely for interest; that A. O. Stewart, acting for both of the petitioners, read the circulars and bulletins issued by the Farm Loan Board; read the covenants of the bonds themselves, and believed in and relied on what he read as exempting increment on these bonds, and so believing and relying he entered into the transactions here in question.

Upon this showing and for the reasons outlined, if your Honor please, we shall ask for judgment by the Court.

Miss Phillips: Would your Honor like to hear a statement from me at this time?

The Court: Just as you wish, Miss Phillips. [44]

Miss Phillips: I will make it very brief.

As your Honor perceives, the main question is whether or not an income derived by profits made in the sale of bonds is exempt from taxation.

The Court: Yes.

Miss Phillips: The statute clearly exempts interest paid upon the principal of a bond, but where the individual buys bonds and sells them by dealings in the market, or by surrender of them, whether those profits are taxable.

On the last point that counsel suggested, that there is an estoppel in this case, at the appropriate time I shall object to evidence on estoppel on the ground that such an issue is not raised in the pleadings. No issue is presented upon that in the pleadings.

The Court: Will you proceed, counsel?

Miss Phillips: One question your Honor asked, whether or not the Supreme Court ever passed on such a question. We shall direct your Honor's attention to the fact that in dealings on Government bonds, such as Liberty Bonds and State and municipal bonds, the Court has ruled in the case of Willcox v. Jones, reported in 288 United States, it was ruled that income derived from dealings in bonds was not exempt even though the interest on the bond itself was exempt by appropriate or constitutional provision.

The Court: You may proceed.

Mr. Harmon: If your Honor please, I was under the impression that estoppel had been pleaded in our complaint; and if it has not been pleaded I at this time ask leave to move the Court to amend the petitions.

The Court: I don't know whether it is pleaded or not.

Mr. Harmon: I am having it checked. [45]

The Court: You may have that privilege of asking to amend after you have satisfied that in your own mind.

A. O. STEWART,

called for the plaintiffs, sworn.

The Clerk: Will you state your name to the Court, please? A. A. O. Stewart.

Direct Examination

Mr. Harmon: Q. Mr. Stewart, you are one of the petitioners in this case? A. I am.

Q. And your wife is the other petitioner?

A. She is.

Q. What is your occupation, Mr. Stewart?

A. Banking and investments.

Q. What banks are you connected with?

A. President of the Pacific Coast Joint Stock Land Bank; President of Phoenix Joint Stock Land Bank in Kansas City; chairman of the Board of Directors of the Federal Reserve Bank of San

(Testimony of A. O. Stewart.)

Francisco; and Federal Reserve Agent, Twelfth District.

Q. Have you been connected with any other joint stock land banks than those that you have mentioned?

A. I have been an officer in several different banks, including the two I have just named; and up until the time I sold the Des Moines Bank I was president of the Des Moines Bank and vice president of the Pacific Coast Joint Stock Land Bank of Salt Lake City and a director of the Pacific Coast Joint Stock Land Bank of Portland.

Q. Mr. Stewart, during and prior to the year 1931 have you purchased and sold any joint stock land bank bonds individually or as an officer for any of the corporations which you have mentioned?

A. I have acted in both capacities,—as an officer of the banks [46] in which I was interested, and I have purchased large amounts of these bonds for the banks themselves——

The Court: Q. On the open market?

A. From dealers, yes.

Mr. Harmon: Q. Were your transactions in the capacity——

The Court: He hasn't finished his answer.

Mr. Harmon: I beg your pardon.

A. And as an individual, for myself I have purchased a large number of these bonds; also for my wife and family and other corporations in which I was interested.

(Testimony of A. O. Stewart.)

Q. Did you buy these bonds or enter into these transactions as a dealer in the bonds or as an investor?

A. No, I am not a dealer; I have no dealer's license; purely as an investment and in the hope and belief that there would be an enhancement or an increment in these bonds.

Q. When did you purchase the bonds of the Kansas City Joint Stock Land Bank with which we are concerned in this case? A. In 1930.

Q. Do you remember, were they purchased at more than one time?

A. Yes, I can give you the exact dates, if I may refer to a memorandum.

Miss Phillips: No objection to referring to a memorandum.

A. In July 11, 1930, in August 11, 1930, September 1930, October 1930, and November 1930, there was a total of $894,000 par value purchased, and the amount paid for them was $479,098.13, an average of about 55 cents plus per bond per dollar.

Mr. Harmon: Q. You have stated that the total par value was four hundred ninety odd thousand?

A. No, 894,000.

Q. 894,000?

A. Of that lot, and there were others.

Q. Mr. Stewart, it has been stipulated and admitted that the [47] par value of the particular bonds concerned here is $886,000. Just to keep the

(Testimony of A. O. Stewart.)

record straight, that is the amount of bonds that you surrendered to the receiver in 1931, isn't it?

A. That is correct.

Q. $886,000? A. That is correct.

Q. Some bonds you surrendered later on?

A. Yes.

Mr. Harmon: With those we are not concerned here.

The Court: They came in another year?

Mr. Harmon: Yes.

Q. Now, do you have the dates when you purchased the bonds of the Bankers Joint Stock Land Bank? A. I have.

Q. Will you give those dates, please?

A. They were purchased in January 1930 and July 1930, August 1930, September 1930, October 1930, November 1930 and December 1930, and May 1931 $2,000.

Q. Those were the bonds that were sold by you during 1931? A. Yes.

Q. Of the Bankers Joint Stock Land Bank?

A. That is correct.

Miss Phillips: That is that Milwaukee Bank you are referring to?

Mr. Harmon: The Milwaukee Bank.

Q. Do you know whether or not these banks, or either of them, were in receivership at the time you purchased the bonds?

A. Both of the banks were in receivership.

(Testimony of A. O. Stewart.)

Q. Do you know when they went into receivership? A. In 1927.

Q. Did you buy these bonds in contemplation of receiving interest thereon or capital gain or increment?

A. The bonds were purchased flat. The banks were in receivership; they were paying no interest. I naturally purchased the bonds in the hope that there would be an increment in the value of them. [48]

Q. Mr. Stewart, are you familiar with the provisions of the Federal Farm Loan Act?

A. I am. I have read it a number of times.

Q. Are you familiar with the securities issued under that act? A. I am.

Q. When did you first become interested in the Farm Loan system and its securities?

A. Well, I have been familiar with the act from the time it was passed in 1916. I gave more intensive and active study in 1929, at which time I was approached by the officers of the American Trust Company to buy the stock of the Pacific Coast Joint Stock Land Bank, which was at that time owned by the American Trust Company.

Q. Have you made a study of the Farm Loan Act and the securities? A. I have.

Q. What has your study consisted of?

A. The reading of the act itself, and from many, many bulletins that have been put out by the Treasury Department, and from—I have also read the

(Testimony of A. O. Stewart.)

opinion of Charles Evans Hughes rendered to the Investment Bankers as to the constitutionality of the act; also the opinion of the Attorney General, and also some cases pertaining to the constitutionality of the act.

Q. Where did you get the circulars which you have mentioned?

A. From various dealers from whom I have purchased the bonds I requested that they send me circulars pertaining to the issues. I have also got a number of bulletins from the files of my own bank that were put out by the Treasury Department, and from whatever source that others were available.

Q. Did you pay any particular attention in your study to the matter of tax exemption?

Miss Phillips: At this time I object to the question as calling for testimony that is incompetent, irrelevant and immaterial. [49]

The Court: I do not think it is material, but he may answer subject to the objection. It is before the Court. Go ahead.

A. That was one of the principal inducements that led me to purchase these bonds.

Mr. Harmon: Q. Why?

A. Because of the sweeping exemption granted by the—granted in the bond itself. It was a peculiar bond of uncommon character, in that it was an instrumentality of the Government; it was not guaranteed by the Government; and I was interested in finding out why this sweeping exemption was put in

(Testimony of A. O. Stewart.)

this particular bond. In fact they are the only bonds that I know of issued by the Government or any instrumentality which exempted all of the income. The word "interest" is not used in the bond at all.

Mr. Harmon: At this time I wish to offer in evidence a photostatic copy of a document entitled: "Farm Loan Primer, Circular No. 5," issued by the Federal Farm Loan Board.

Miss Phillips: I object to the introduction of this document in evidence on the ground that it is incompetent, irrelevant and immaterial, not binding on the defendant and as not evidence properly bearing on the question involved in this case. I do not raise an objection on the ground of authenticity. This is a photostatic copy, apparently.

The Court: It may be received subject to the objection made.

(The document referred to was marked

PLAINTIFFS' EXHIBIT 1.)

[Exhibit 1 is a pamphlet issued by the Treasury Department, Federal Farm Loan Board, as Circular No. 5, revised, entitled "The Farm Loan Primer", printed by the Government Printing Office and bearing on its front cover a statement that "Here you will find in brief form answers to the questions most frequently asked about the Federal Farm Loan Act and amendments thereto."]

(Testimony of A. O. Stewart.)

Mr. Harmon: Q. I hand you what has been marked as Plaintiffs' Exhibit 1 and ask you if you have seen that before or a copy of it?

A. I have seen it before. It is a Farm Loan primer that was put out by the Treasury Department— [50] by the Farm Loan Board, a branch of the Treasury Department, to acquaint the public with the character of the investment and to induce the public to invest in these farm loan bonds.

Q. When did you first see this or a copy of it, Mr. Stewart? A. On or about 1928 or 1929.

Q. On page 8 of that exhibit I find the following language in question and answer form. I will read it to you:

> "Q. You have spoken entirely from the point of view of the farmer borrower. Suppose a person has money to invest, how does this system interest him?
>
> A. The bonds of the Federal Land banks ought to be a very attractive investment for him.
>
> "Q. Why?
>
> A. Because they are secure, command a ready market, and are free of all forms of taxation."

And then down commencing with question 75:

> "Q. You say the bonds are free of all forms of taxation. Does that include income tax and all forms of State and municipal tax of every kind and character? A. Yes.

(Testimony of A. O. Stewart.)

Q. And is the income of these bonds also free of taxation? A. Yes."

Did you read that language at the time you examined this, Mr. Stewart? A. I did.

Q. What did you understand the language to mean with reference to taxing gains derived from the bonds through their purchase and sale?

Miss Phillips: Just a moment. That is objected to as calling for the witness' statement of a conclusion of law which he drew himself.

The Court: He may answer subject to the objection. I doubt the propriety of it. [51]

Mr. Harmon: If your Honor please, it goes to the matter of estoppel.

The Court: I am letting it in subject to objection. I don't care for any comments on it now.

A. I construed it to mean that the income, from whatever source or character, pertaining to or derived from these bonds was exempt.

Mr. Harmon: Q. Did that include in your idea capital gains? A. It did.

Q. I ask you if you relied on these statements that I have just read in purchasing these bonds of the Kansas City Bank and the Bankers Joint Stock Land Bank?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

(Testimony of A. O. Stewart.)

A. Yes, I relied on those statements, together with many others in other bulletins.

Mr. Harmon: I now wish to offer in evidence a photostat of the circular dated May 15, 1918, is the proper date, issued by the Federal Farm Loan Board.

The Court: What date?

Mr. Harmon: May 15, 1918.

Miss Phillips: That is objected to as incompetent, irrelevant and immaterial. No objection made on the ground of authenticity, your Honor.

The Court: Received subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 2

in evidence.)

[Exhibit No. 2 is a photostatic copy of Circular No. 9, issued by the Federal Farm Loan Board of the Treasury Department, Washington, D. C., under date of May 15, 1918, pertaining to Federal land bank 5% farm loan bonds dated May 1, 1918, and due May 1, 1938. On the second page, in addition to the statement referred to hereinafter, is the following statement:]

> "These bonds are declared by the Act to be 'instrumentalities of the Government of the United States,' and as such the income therefrom are exempt from Federal, State, municipal and local taxation. This includes the Fed-

(Testimony of A. O. Stewart.)

eral income tax, and income from these bonds need not be included in income tax returns."

Mr. Harmon: Q. Mr. Stewart, have you ever seen a copy of this document marked Exhibit 2, which I now hand you? [52]

A. I have, yes.

Q. Do you remember when you first saw it?

A. It was in '28 or '29, just about the time that I purchased this bank.

Q. On the first page of this circular in caps appears these words: "Exempt from federal, state, municipal, and local taxation." On the second page in italics appear these words: "The constitutionality of the act and the validity of the provisions exempting the bonds from taxation have been approved by the Attorney General of the United States on behalf of the Government and by eminent counsel in behalf of private interests." On the third page appears this language: "Tax exemption. Free of Federal, State, city and local taxes. The act states that: 'the Farm Loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.' "

And the further statement: "It will be noted that this exemption is complete, and that in addition to the exemption from State, city and local taxation,

(Testimony of A. O. Stewart.)

the bonds are free from the normal and additional Federal income tax and need not be included in income tax returns."

Do you recall having read that language before, Mr. Stewart? A. I did.

Q. What did you understand that language to mean as regards the kind of income which is in controversy here?

Miss Phillips: I make the same objection, your Honor, as I did to the previous question; it is incompetent, irrelevant and immaterial, and calls for the witness' opinion on a question of law. [53]

The Court: He may answer subject to the objection.

A. That it was—that the income was exempt.

Mr. Harmon: Q. Did you rely on those statements that I have just read in making the purchases of the bonds which are in question here?

A. I did.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Same ruling.

Mr. Harmon: Q. This circular refers, Mr. Stewart, to opinions of the Attorney General and of eminent counsel on behalf of private interests. Did you read any of those opinions?

A. I read the opinion of Honorable Charles E. Hughes as to the constitutionality of the act and the

(Testimony of A. O. Stewart.)

continuing exemption granted under that act and also the opinion of the Attorney General.

Mr. Harmon: I wish to offer in evidence at this time a photostatic copy of that portion of the opinion of the Honorable Charles E. Hughes to which has been referred and which pertains to the tax exemption feature.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: I may want to read it anyhow. It may be admitted subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 3

in evidence.)

Mr. Harmon: Q. Reading the concluding paragraph of that opinion, Mr. Stewart, as follows:

> "My conclusion is that the farm loan bonds to be issued by the Federal Land Banks organized and controlled as provided in the Federal Farm Loan Act will be, when duly issued and paid for, valid securities, constituting as de- [54] clared by Congress instrumentalities of the Government of the United States, and that they and the income derived therefrom will be exempt as provided in the Act from Federal, State, municipal and local taxation; and further that, with respect to bonds duly issued and paid for under this exemption, it will constitute a con-

(Testimony of A. O. Stewart.)

tinuing exemption which cannot be withdrawn by subsequent legislation."

You read that language, did you?

A. I did.

Q. What did you understand that language to mean with reference to the particular type of income which the Government now seeks to tax?

Miss Phillips: Objected to as calling for the witness' opinion on a question of law—a conclusion of the witness.

The Court: He may answer subject to the objection.

A. That the income derived from these bonds was exempt and that it was a continuing exemption regardless of ownership.

Mr. Harmon: Q. And did you rely on that understanding in making the purchases of bonds which are the root of this case?

Miss Phillips: Just a moment. Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to the objection.

Mr. Harmon: I now desire to offer in evidence photostatic copies of three pages of a document known as "The Borrowers' Bulletin," issued by the Federal Farm Loan Bureau of the United States Treasury Department, the first page being from an issue of June-July 1918, the second page from the issue of November 1917, and the third page from the issue of February-March 1918.

(Testimony of A. O. Stewart.)

Miss Phillips: That is objected to as incompetent, irrele- [55] vant and immaterial. I do not object to the authenticity of those pages.

The Court: Received subject to objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 4

in evidence.)

[Exhibit No. 4 consists of photostatic copies of three pages from a circular entitled, "The Borrower's Bulletin", issued by the Federal Farm Loan Bureau, U. S. Treasury Department, the first being from the June-July, 1918, issue, the second from the February-March, 1918 issue, and the third from the November, 1917 issue.]

Mr. Harmon: Q. Reading now from the issue of June-July 1918, I call your attention, Mr. Stewart, to this language:

> "any doubt as to the public appreciating or desiring these new bonds which are tax-free and instrumentalities of the Government has been dispelled for all time." Later on in the same article, center column: "Next to tell the investor, large and small, that Federal farm loan bonds are an excellent security, one that pays a good rate of interest and is exempt from every form of taxation—even the income from them is exempt."

(Testimony of A. O. Stewart.)

And again on the last column of that page:

> "Of added interest at this time is the fact that the Federal farm loan bonds are exempt from every form of taxation—Federal, State or local—with the single exception of succession and inheritance taxes."

Then on the first column of the page from the November 1917 issue there is this paragraph:

> "These bonds possess many attractive features as an investment for farmers. They bear an interest rate of 4½ per cent, and they are entirely free of all forms of taxation with the exception of inheritance tax. They are free from income tax. They are regarded as one of the most attractive investments ever offered in this country."

In the first column of the February-March 1918 issue are these words:

> "Buy Federal farm loan bonds and forget about the taxes on them. Neither the township, town, village, city, [56] school district, county, State or United States Government can tax them. This exemption from taxation is offered so that the farmers will no longer have to pay taxes through increased interest rate on what they owe. The income from Federal farm loan bonds is also exempt from taxation."

(Testimony of A. O. Stewart.)

Mr. Stewart, did you read these words which I have just quoted?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to the objection.

A. I did.

Mr. Harmon: Q. And what did you understand those words to mean with reference to the type of tax which the Government now seeks to assert?

Miss Phillips: Objected to as calling for the opinion of the witness on a conclusion of law; the further objection that it is incompetent, irrelevant and immaterial.

The Court: Same ruling.

A. That the income of whatever character was exempt.

Mr. Harmon: Q. Including the type here at issue?

A. Including the type at issue in this case.

Q. Did you rely on that understanding in purchasing these bonds? A. I did.

Mr. Harmon: I wish to offer in evidence a document bearing date May 1st, 1921—a photostatic copy, rather of a document bearing that date, issued by the Treasury Department.

Miss Phillips: That is objected to as incompetent, irrelevant and immaterial.

The Court: It may be received subject to the objection.

(The document referred to was marked

(Testimony of A. O. Stewart.)

PLAINTIFFS' EXHIBIT No. 5

in evidence.) [57]

[Exhibit No. 5 is a photostatic copy of Circular No. 12 issued by the Treasury Department, Federal Farm Loan Bureau, pertaining to Federal land bank 5% farm loan bonds dated May 1, 1921, and due May 1, 1941. On page 2 appears a statement, "The Supreme Court of the United States has recently passed upon and fully approved the constitutionality of the Act and the validity of the provisions exempting the bonds from taxation." On page 3 appears the following: "Tax Exemption. Free of Federal, State, City and local taxes. The Act states that: 'The farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation'. It will be noted that this exemption is complete, and that in addition to the exemption from State, city, and local taxation, the bonds are free from normal and additional Federal income tax and need not be included in income-tax returns."]

Mr. Harmon: Q. I show this document to you, Mr. Stewart, and ask you if you have ever seen this before or a copy of it? A. I have, yes.

Q. When did you see it the first time, as near as you can remember?

A. In '28—1928 or '29.

(Testimony of A. O. Stewart.)

Q. On the first page in caps are these words: "Exempt from Federal, State, municipal, and local taxation," and on the third page are these words: "Tax exemption. Free of Federal, State, City, and local taxes."

"The Act states that:" and quotes the same provision which I have quoted before, and adds this statement: "It will be noted that this exemption is complete, and that in addition to the exemption from State, city and local taxation, the bonds are free from normal and additional Federal income-tax and need not be included in income-tax returns."

Did you read those words at the time you saw this document the first time, Mr. Stewart?

A. I did.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

Mr. Harmon: Q. And did you have the same understanding as to the meaning of those words which you have gathered from these other circulars which we have discussed?

Miss Phillips: Same objection; calling for the witness' conclusion on a question of law; the further objection that it is incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

A. My understanding was that there was a com-

(Testimony of A. O. Stewart.)

plete objection as to whatever income was derived from these bonds.

Mr. Harmon: Q. And did you rely on this statement along with [58] the others in making your purchase of bonds under the Federal Farm Loan Act?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Same ruling.

A. I did.

Mr. Harmon: Q. Now, Mr. Stewart, did you study any other circulars or material regarding these Farm Loan bonds?

A. Yes, I read all that I could find—could get hold of.

Q. Would you say that those that have been received in evidence are typical of the type of circulars put out by the Government?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Mr. Harmon: Q. Mr. Stewart, did you ever read in any circular or bulletin issued by the Treasury Department or any other branch of the Government anything which negatived the idea that these bonds and all income derived therefrom were exempt?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

(Testimony of A. O. Stewart.)

The Court: He may answer subject to the objection.

A. No, I have never seen anything in any of the bulletins that held otherwise than stated on the face of the bonds.

Mr. Harmon: Q. Before you purchased these bonds had you examined and read any——

Miss Phillips: Which bonds are you referring to? You say "these bonds". Which bonds?

Mr. Harmon: These bonds here in question. Had you examined and read any farm loan bonds?

[59]

Miss Phillips: Just one moment, counsel. There are two different sets of bonds. You mean referring to both of the bonds?

Mr. Harmon: I am speaking now if he has examined and read any farm loan bonds. It has been stipulated, if your Honor please, that all Farm Loan bonds are similar except for certain differences which are not material here.

Miss Phillips: Counsel's question——

The Court: Are you asking about other bonds prior to the purchase of these bonds involved?

Mr. Harmon: I am now trying to——

The Court: It doesn't make any difference if he says he read these or not; he knew what was in them and relied upon legal opinion.

Mr. Harmon: Q. I will ask you this question: Did you read any of these bonds which you purchased?

(Testimony of A. O. Stewart.)

A. Yes, I have read them over carefully.

Q. Calling your attention to this language in the bonds:

> "This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that: 'Farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States and as such, they and the income derived therefrom shall be exempt from Federal, State, Municipal, and local taxation.' "

What did you understand that language to mean as regards income through increment of the bonds such as is involved in this case?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial, calling for the witness' conclusion on a question of law. [60]

The Court: Of course, I think we are getting awfully far astray here again. I am not going to decide this lawsuit at all on what Mr. Stewart understood.

Mr. Harmon: I understand that, your Honor.

The Court: I am going to decide it on what the law means.

Mr. Harmon: That is probably the principal issue.

The Court: And he can't change it. What he believed and what he had in mind and what his interpretation may have been and what his induce-

(Testimony of A. O. Stewart.)

ment was, he can't change the law; it must stand on its own legs—on its own bottom.

Mr. Harmon: Here, if your Honor please, we come into that question of estoppel, and if——

The Court: Well, but you have got your records that create an estoppel, if there is an estoppel. Now you are going much further than that.

Mr. Harmon: We are only going to the question——

The Court: The last question is too broad, I think.

Mr. Harmon: I think we should show what the witness understood and that he relied on that language in making these purchases.

The Court. It is not a question, after all, of what he understood; it is a question of what a reasonably minded man will understand.

Mr. Harmon: That is correct. That is true.

The Court: Mr. Stewart may have wanted to read something into this in the way he understood it. We cannot test it by his understanding; we must test it by the understanding of a reasonably intelligent man reading that language and what he understood by it.

Mr. Harmon: I will withdraw the last question and reframe it this way: [61]

Q. Did you rely on the words contained in the covenant of that bond which I just read to you in making these purchases? A. I did.

(Testimony of A. O. Stewart.)

Mr. Harmon: It seems to me, if your Honor please—I have proceeded on the theory that not only must it be what a reasonable man understood from this language, but unless we can show——

The Court: That probably is a rather misleading suggestion on my part. After all, the question is the question of interpretation of law; the question of the interpretation of a contract is wholly one for the Court.

Mr. Harmon: That is true.

The Court: It doesn't make any difference whether A and B who entered into a contract understood that it meant something different from what the Court found it to mean. The question after all is what does that contract mean, and what it means is not to be determined by the parties to it but by the agency of the government that is put up here to interpret it,—that is, the court.

Mr. Harmon: I believe now that the record shows clearly enough the point that I am getting at.

The Court: Of course you have shown here—there has been admitted subject to objection—that Mr. Stewart was familiar with the language in these bonds; he knew about them; he had read these bulletins; he read the opinion of Mr. Hughes; and states that was before he purchased the bonds.

The Witness: It was, your Honor.

The Court: And you have shown that he was interested in these bonds and induced to buy them,

(Testimony of A. O. Stewart.)

probably upon the belief, acting reasonably, founded on a proper interpretation of the statute and of the bonds themselves, that he was procuring an instrument that was tax-free not only in the sense of [62] income derived therefrom but also in the sense of profit derived from the bond selling at a higher price than was paid for it. Whether he was right or wrong—and after all I have got to decide—I can't be helped very much by what he believed.

Mr. Harmon: We merely offer that to show that he did act in reliance upon this understanding.

The Court: You have shown all that. I have no idea that the Government intends to controvert that now. Have you, Miss Phillips?

Miss Phillips: I think my position on it is exactly the same as your Honor's: that after all it is a question of law: what did Congress intend.

The Court: You are not going to controvert the fact that Mr. Stewart did rely on these things as a fact? You are not going to bring in any evidence to controvert that?

Miss Phillips: I really have admitted the authenticity of these exhibits. They appear on their face to be issued by the Treasury Department.

The Court: You contend that isn't the proper interpretation. You don't intend——

Miss Phillips: I am not saying about the statement of his mind on these things——

The Court: You don't intend to introduce any evidence to contradict what he says?

(Testimony of A. O. Stewart.)

Miss Phillips: I think not, but there is one point on which I want to question him in view of this last issue of estoppel.

The Court: I am trying to limit the examination to such extent that we are not going so far afield as to be in a place alien entirely to the question we are considering.

Mr. Wilkinson: May it please the Court, our theory in asking this line of questions, from an examination of cases [63] dealing with estoppel, is just this: that in order to make out a case of estoppel it is necessary not only to show that not only acting as a reasonable and prudent man he had a right to rely upon them, but that in fact he did rely upon them.

The Court: He has testified to that. He has said that a number of times. He has been asked specifically about these specific instruments. I have permitted him to testify that he did rely on them.

Mr. Wilkinson: That is right, your Honor.

The Court: I have even permitted him to testify as to his understanding, which I think you must agree with me——

Mr. Wilkinson: We want it plain that we thought that the burden was upon us not only to prove an objective test but also a subjective test of the petitioner here. That is why we ask these particular questions.

The Court: Well, you have proved it.

(Testimony of A. O. Stewart.)

Mr. Harmon: At this time I desire to offer in evidence a typewritten copy of a document signed by the General Counsel of the Bureau of Internal Revenue dated April 3, 1933. It pertains to a ruling of the General Counsel's office in the case of the Des Moines Joint Stock Land Bank of Des Moines, Iowa, to which I alluded in my opening statement, and that portion of the exhibit which particularly we are interested in is that pertaining to the fourth issue present in that case: "Taxability of discount on taxpayer's own bonds purchased during the taxable year." There are several pages of this that do not pertain to that, and if it is——

The Court: If you offer this and it is received, you may, at your convenience, make an excerpt copy therefrom directly under quotation marks of the particular part that you desire to [64] have in the record and submit it to Miss Phillips.

Miss Phillips: This is an authentic copy of the ruling of the General Counsel's office, your Honor.

The Court: It won't be necessary to keep the whole document in evidence if you will indicate the parts that you desire to have admitted.

Mr. Harmon: We will just extract those particular pages and leave them, your Honor.

Miss Phillips: This is an authentic copy of the opinion of the General Counsel on several issues of law involved in the Des Moines Joint Stock Land Bank case. My objection to this would go not to its

(Testimony of A. O. Stewart.)

authenticity but that this is an opinion on a question of law by the General Counsel of the Bureau at that time and as being incompetent, irrelevant and immaterial; and the further ground that this opinion relates to the status of a joint stock land bank itself, which is a governmental agency, in the taxability of its own income, and not applicable to the question of the taxability of the income of an individual.

The Court: It may be received subject to the objections.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 6

in evidence.)

[Exhibit No. 6 is a copy of an opinion and ruling by the General Counsel of the Bureau of Internal Revenue under date of April 3, 1933, in a case involving the Des Moines Joint Stock Land Bank. The pertinent part of this opinion, referred to by counsel as the Des Moines opinion is as follows:]

OPINION OF GENERAL COUNSEL OF BUREAU OF INTERNAL REVENUE

Des Moines Joint Stock Land Bank

CC:I:STH

Apr 3 1933

In re: Des Moines Joint Stock Land Bank,
Des Moines, Iowa.

Deputy Commissioner Wilmer:

Reference is made to the memorandum (IT:AR:D4:JWH) dated July 19, 1932, addressed

(Testimony of A. O. Stewart.)

to the representative of this office attached to the Income Tax Unit by the head of the Audit Review Division, in which an opinion is requested as to the taxability in general of all profits on the capital and surplus of joint stock land banks.

At a hearing before this office and in brief filed on October 3, 1932, four specific issues were raised, as follows:

1. Deductibility of interest paid on outstanding loan farm loan bonds of the taxpayer in excess of interest received on first mortgages owned by the taxpayer.
2. Determination of the date when the exemption granted to income from first mortgages ceases.
3. Deductibility for income tax purposes of real estate appraisal losses taken by the taxpayer pursuant to regulations of the Federal Farm Loan Board.
4. Taxability of discount on taxpayer's own bonds purchased during the taxable year.

* * * * * * *

Issue 4

Relative to the fourth issue it appears from the facts that the taxpayer, during 1929, purchased on the open market a total of $1,144,000.00 par value of its own bonds. Of this

(Testimony of A. O. Stewart.)

amount the taxpayer cancelled and retired all but $230,000.00 par value of these bonds. The $230,000.00 par value not retired were pledged as collateral with the First National Bank of Chicago to secure notes owing to that bank in the sum of $84,425.00. For the bonds not cancelled, the taxpayer paid $139,235.00, a discount of $90,765.00.

The taxpayer contends (1) that all discount on federal farm loan bonds purchased by it is tax exempt; and (2) assuming that the discount realized on the purchase of the bonds retired is taxable, the sum of $90,765.00 was not income realized by actual retirement of bonds during that year.

Relative to the taxpayer's first contention, reference is made to Section 26 of the Federal Farm Loan Act, quoted in part under the discussion of issue two. It will be noted that the act provides that farm loan bonds *and the income derived therefrom,** shall be exempt from Federal, State, municipal and local taxation. Section 26 is cited and stated in article 85 of Regulations 74, which provides that the interest from farm-loan bonds is not subject to the income tax.

Section 22(b) (4) (B) of the Revenue Act of 1928 provides that interest upon securities

*Italics supplied.

(Testimony of A. O. Stewart.)

issued under the provisions of the Federal Farm Loan Act, or under the provisions of said Act as amended, shall be exempt from taxation.

Article 68 of Regulations 74 provides that if a corporation purchases and retires any of its own bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year. This establishes the fact that the gain from the purchase of the taxpayer's bonds constitute INCOME. See also Kirby Lumber Company v. United States (284 U. S. 1).

The United States Supreme Court, in holding unconstitutional a Massachusetts Statute taxing corporations in proportion to their income, including income from farm loan bonds, said: "Federal Farm Loan Bonds issued under authority of Chapter 245, 39 Stat. at L. 360 (July 17, 1916) U. S. C. Title 12, #641, and by #26 p. 380 Title 12, #931 are declared to be instrumentalities of the United States and both as to principal and INCOME exempt from all State taxation." (Underscoring supplied). McCallen Co. v. Massachusetts (49 Supp. Ct. Rep. 432).

The original Federal Farm Loan Act was approved on July 17, 1916. The Revenue Act of 1916 was approved on September 8, 1916, and contained among others the following provisions relative to income exempt from tax.

(Testimony of A. O. Stewart.)

Section 4:

> "Interest upon the obligations of a State or any politicial subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen."

Section 11 (a) (14)

> "Joint stock land banks as to income derived from bonds or debentures or other joint stock land banks or any Federal land bank belonging to such joint stock land banks."

The above provision appears under the head of "Conditional and other Exemptions", relating to corporations, and was eliminated in the draft of the 1918 Act. The report of the Committee on Ways and Means, in the draft of the 1918 Act, states as follows:

> "The bill makes no change in the corporations exempt from income tax."

Section 22 of the Revenue Act of 1928 includes in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or personal."

In re Federal Land Bank of New Orleans v. Crossland (43 Supp. Ct. Rep. 385) a writ of

(Testimony of A. O. Stewart.)

mandamus was requested, to require the recording of a mortgage upon the payment of the recording fee, without the payment of an additional sum of fifteen cents for each one hundred dollars of the principal sum secured. In that case the Supreme Court held this to be a tax upon the mortgage and forbidden by the law of the United States.

The Federal Farm Loan Act as amended, contains both the words "income" and "interest". Paragraph 22 of that act specifically provides that amortization and other payments on the principal of first mortgages shall, in the case of a joint stock land bank, be applied or employed to pay off farm bonds, issued by such bank as they mature and to purchase at or below par farm loan bonds. It is apparent, therefore, that Congress recognized the fact that income might be realized through the purchase at below par of farm loan bonds.

There is no statute which exempts all income derived from state and municipal securities, similar to the Federal Farm Loan Act exemption with reference to joint stock and Federal land bank bonds. The distinction is brought out by the Supreme Court in Wilcutts v. Bunn (282 U. S. 216), which held that income derived from dealing in state and municipal securities was not exempt from Federal income tax

(Testimony of A. O. Stewart.)

since the exemptions was limited to interest therefrom.

It is important to note the distinction between the words used in granting the exemption to various other tax exempt bonds. The Federal Farm Loan Act provides that farm loan bonds "and the income derived therefrom" shall be exempt from all taxation. Other statutes authorizing the issuance of tax exempt bonds provide that such bonds shall be exempt "as to principal and interest." First Liberty Loan Act; Second Liberty Loan Act; War Finance Corporation Act; Third Liberty Loan Act; Fourth Liberty Loan Act; Victory Liberty Loan Act.

Section 26 of the Federal Farm Loan Act specifically exempts Federal land banks and national farm loan associations from Federal, State, municipal, and local taxation, except taxes upon real estate held. The exemption specifically applies to the capital and reserve or surplus and "the income derived therefrom." The words "income derived therefrom" as there used have been interpreted by the Bureau to mean any gains or profits derived from dealing in capital and reserve or surplus. In the same paragraph of the same section, farm loan bonds and the "income derived therefrom" are

(Testimony of A. O. Stewart.)

exempted. It would be inconsistent to define the words "income derived therefrom" found in the third line of section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest.

In the instant case, the bonds in question were issued by this taxpayer, and purchased by it at a discount, both under specific authority of the Federal Farm Loan Act. As a result of the purchase, the taxpayer derived income within the meaning of the Revenue Act of 1928. Kirby Lumber Company v. United States, supra. Under such circumstances, it is the opinion of this office that the income so derived, was derived from the bonds as contemplated by the Federal Farm Loan Act. It is concluded, therefore, that the discount on the taxpayers own bonds purchased during the taxable year, constitutes exempt income and is, therefore, non-taxable. It becomes unnecessary to pass upon the taxpayers' alternate contention relative to the question of bond discount.

In conclusion, it is the opinion of this office (1) that the interest paid on taxpayer's bonds in 1929, in excess of the tax-exempt interest received on first mortgages owned by the taxpayer, constitutes a proper deduction in computing taxable net income; (2) that the exemp-

(Testimony of A. O. Stewart.)

tion granted to the income from first mortgages ceases when the mortgages are converted into substitued form of collateral; (3) that the appraisals made by the Federal Farm Loan Board after the acquisition of property at foreclosure sale, in the absence of fluctuation in value between date of acquisition and date of appraisal, form a proper basis for the recognition of gain or loss; and (4) that discount on the taxpayer's own bonds purchased during the taxable year constitutes exempt income and is, therefore, non-taxable.

The administrative file is herewith returned.

C. M. CHAREST,
General Counsel,
Bureau of Internal
Revenue.

Encl. No. 69465.

Mr. Harmon: I now wish to offer in evidence a photostatic copy of a letter dated May 2d, 1933, by the Secretary of the Federal Farm Loan Bureau addressed to all joint stock land banks referring to and quoting from the ruling just admitted.

Miss Phillips: This is an authentic copy, your Honor. My objection is that it is immaterial, irrelevant and incompetent, not controlling on the defendant.

The Court: Received subject to the objection.

[65]

(Testimony of A. O. Stewart.)

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 7

in evidence.)

[Exhibit No. 7 reads as follows:]

Treasury Department
Washington
Federal Farm Loan Bureau

May 9, 1933
May 2, 1933.

JSLB 278

To all Joint Stock Land Banks:

A decision has been rendered recently by the Bureau of Internal Revenue, after a hearing before the General Counsel of the Bureau, with respect to the income tax liability of one of the joint stock land banks under the Revenue Act of 1928.

As the issues involved in the case referred to are of widespread interest to joint stock land banks, the following excerpt from the letter of the Bureau of Internal Revenue is quoted for the information of the banks:

"First: That the interest paid on your bonds in 1929 in excess of the tax-exempt interest received on first mortgages owned by you, constitutes a proper deduction in computing taxable net income.

"Second: That the exemption credited to the income from first mortgages ceases when

(Testimony of A. O. Stewart.)

the mortgages are converted into substituted forms of collateral.

"Third: That the appraisals made by the Federal Farm Loan Board after the acquisition of property at foreclosure sales, in the absence of fluctuated value between date of acquisition and date of appraisal, form a proper basis for the recognition of gain or loss.

"Fourth: That the discount on your own bonds purchased during the taxable year constitutes exempt income and is, therefore, nontaxable."

F. D. VAN SANT,
Secretary.

Mr. Harmon: Q. Mr. Stewart, are the banks which you are now an officer of members of the National Association of Joint Stock Land Banks?

A. They are, yes.

Q. Have you participated in the activities of that association?

A. I was an officer and a member of the executive committee of that association.

Q. Are you informed personally as to whether or not the Joint Stock Land Banks organized under the Farm Loan Act have dealt in their own bonds and bonds of other banks?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial, not tending to prove any of the issues in this case.

(Testimony of A. O. Stewart.)

The Court: He may answer subject to the objection.

A. I know that they have dealt in bonds of other banks, yes.

Mr. Harmon: Q. And also in their own bonds?

A. As well as their own bonds.

Q. Do you know from your own knowledge of those banks and their dealings how much, if any, profit or gain those banks have made from dealings in their own bonds and bonds of other banks?

Miss Phillips: Objected to as incompetent, irrelevant, immaterial, not tending to prove any of the issues in this case.

The Court: Objection sustained.

Mr. Harmon: If the Court please, this is preliminary to showing——

The Court: The objection is sustained, counsel.

Mr. Harmon: At this time I wish to offer in evidence photostatic copies of agreements as to final determination of tax liability made by the Commissioner of Internal Revenue [66] with seven joint stock land banks: the Pacific Coast Joint Stock Land Bank of Salt Lake City, the Pacific Coast of San Francisco, the Denver Joint Stock Land Bank of Denver, the San Antonio Joint Stock and Land Bank of San Antonio, the Phoenix Stock and Land Bank of San Antonio, the Phoenix Joint Stock and Land Bank of Kansas City, the Des Moines Joint Stock Land Bank of Des Moines, Iowa, and the Burlington Joint Stock Land Bank of Des Moines, Iowa.

Miss Phillips: For what purpose?

(Testimony of A. O. Stewart.)

The Court: What are they?

Mr. Harmon: These are closing agreements, if your Honor please, entered into under Section 606, I think, of the Revenue Act definitely closing and terminating tax liability of these banks in question on the basis of no tax due. This evidence is offered as another administrative interpretation of the Federal Farm Loan Act. We propose to show—I think we have already partially—that these banks all made capital gains, income derived from these bonds—that is, we contend it is derived from these bonds—and that the Department construed those gains as tax-free under the provisions of Section 26. That is another administrative interpretation of the Act as late as 1937. And in that connection, if your Honor please, the Courts have held that such administrative interpretations——

The Court: The rule is clear, when there has been ambiguity the administrative interpretation—the practical interpretation by the administrative department—is admissible; if there is no ambiguity it is not admissible.

Mr. Harmon: That is correct.

The Court: There is no reason for discussing the rule.

Mr. Harmon: That is the theory on which these exhibits are offered. [67]

Miss Phillips: The evidence is objected to on the ground that it is incompetent, irrelevant and immaterial; the further ground that it does not

(Testimony of A. O. Stewart.)

appear from the face of the exhibits as to whether the agreement that no tax is due, whether or not identical questions involved in this case or the taxability of gains was involved in each of these cases for the year in question.

Mr. Harmon: We shall show that, if your Honor please, from the testimony.

The Court: You had better show it first.

Mr. Harmon: Q. All right. Mr. Stewart, you heard the names of the banks which I have just mentioned to the Court in connection with these closing agreements. Do you know of your knowledge whether or not all these banks for the years in questions had gains, capital gains derived from income from these bonds—their own bonds?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Of course it calls for more than that. If these documents have any worth at all, any pertinency, it must be shown that after balancing all losses and debits and credits there was still a profit on the bonds.

Mr. Harmon: We expect to show that.

The Court: Are you going to show that by parol?

Mr. Harmon: We are going to show it by this witness' first-hand knowledge. He was an officer of several of these banks. He knows all about these closing agreements. I think it comes under the best evidence rule. If your Honor desires, Mr. Wilkinson——

(Testimony of A. O. Stewart.)

The Court: How many of those are there?

Mr. Harmon: There are seven. [68]

The Court: Were you familiar with all of those that he read, Mr. Stewart?

A. I am; yes, your Honor.

Q. Each one of them?

A. Each one of them.

Q. And the years in question?

A. And the years in question.

Q. Do you know, as a matter of fact, that there was a profit after balancing losses in the dealings in bonds in each of those institutions for the year that is shown there?

A. I know that there was a profit; yes, your Honor.

The Court: Of course, the record may show that you object to all of this.

Miss Phillips: Yes, your Honor.

The Court: It is received subject to the objection. I think in that situation the exhibits may be received in evidence subject to your objection.

(The documents referred to were marked

PLAINTIFFS' EXHIBIT No. 8

in evidence.)

[Exhibit No. 8 consists of photostatic copies of closing agreements entered into by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury on the one hand, and by seven joint stock land banks on the other hand, all

(Testimony of A. O. Stewart.)

for the year 1934, pursuant to Section 606 of the Revenue Act of 1928, determining that there was no tax liability on the part of any of said banks for said year. As to six of these banks, the Pacific Coast Joint Stock Land Bank of Salt Lake City, the Pacific Coast Joint Stock Land Bank of San Francisco, the Denver Joint Stock Land Bank, the San Antonio Joint Stock Land Bank, the Burlington Joint Stock Land Bank and the Des Moines Joint Stock Land Bank, the agreements were signed by the respective banks on June 5, 1936, and by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, on July 23, 1936; the seventh, the Phoenix Joint Stock Land Bank, the agreement was executed by the bank on January 21, 1937, and by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, on May 27, 1937.]

Mr. Harmon: Q. Now, Mr. Stewart, do you know the extent to which the banks, all of the banks in the Federal Farm Loan System—that is, all the joint stock land banks,—made profits in income during the last several years?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to objection.

A. I know that they did make large profits; in fact, I have computed it.

Mr. Harmon: Q. And that was dealing in their own bonds and bonds of other banks?

(Testimony of A. O. Stewart.)

A. In their own bonds and bonds of other banks. [69]

Q. You said you have computed it. Will you state what that computation was?

A. In excess of——

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to objection.

A. In excess of $100,000,000.

Mr. Harmon: Q. Do you know whether or not that income has been treated as tax-exempt by the Bureau of Internal Revenue?

A. I know that it has.

Q. Are you familiar with the legislation that was passed in 1933 pertaining to the liquidation of joint stock land banks? A. I am.

Q. Will you state what has transpired regarding liquidation of those banks since the act was passed?

A. When the New Deal went into existence they passed—Congress passed a law forcing the joint stock land banks to liquidate their affairs, as it was the purpose of the Government to put all loans through the Federal Land Banks. Pursuant to the enactment of that law we proceeded to sell our mortgages and all our bonds or buy them in the open market and liquidate our affairs.

Q. To whom were these mortgages sold?

A. To insurance companies, to banks, to private individuals, to investors.

(Testimony of A. O. Stewart.)

Miss Phillips: Your Honor, at this time I would like to move to strike from the record questions and answers relating to the new legislation and the effect of it as I did not at first perceive what the purpose of it was or the drift of it. I think it is wholly objectionable and incompetent, irrelevant and immaterial. [70]

The Court: What is the purpose?

Mr. Harmon: The purpose is simply this, if your Honor please: We propose to show from this witness that these banks were required to liquidate and pursuant——

The Court: That is a legal question.

Mr. Harmon: Yes, if your Honor please, that is true; but pursuant to that requirement they proceeded to sell mortgages to customers, whomever they could get; that many of these mortgages had to be sold at large discounts because of the condition of the real estate market; and that in order to enable the banks to dispose of those mortgages a ruling was sought of the Bureau of Internal Revenue on whether or not income derived from these mortgages was taxable.

The Court: Let us have the ruling. I am not interested in all the things that the joint stock land banks did in attempting to comply with the law in 1933.

Mr. Harmon: I offer in evidence a copy of that ruling.

(Testimony of A. O. Stewart.)

Miss Phillips: Objected to as incompetent, irrelevant and immaterial. It is an authentic copy of the particular document.

The Court: You do not question the authenticity?

Miss Phillips: I do not question its authenticity.

The Court: It may be received subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 9

in evidence.)

[Exhibit No. 9 reads as follows:]

Farm Credit Administration
Washington, D. C.

September 12, 1934
JSLB 368

To All Joint Stock Land Banks

Subject: Tax Exemption Provided in Section 26 of Federal Farm Loan Act Continues to Benefit of Purchasers of First Mortgages Executed to Joint Stock Land Banks.

We quote below from a letter dated September 5, 1934, addressed by the Commissioner of Internal Revenue to the General Counsel of the Farm Credit Administration:

"Receipt is acknowledged of your letter of July 9, 1934, in which you inquire whether the income derived from mortgages executed

(Testimony of A. O. Stewart.)

to joint stock land banks which have been sold by such banks to individuals is exempt from taxation.

"You state that a request for a specific ruling has been made by prospective purchasers of the mortgages in question. The ruling in I. T. 2470, C. B. VIII-1, page 69, has been interpreted by you to be applicable to income from mortgages executed to joint stock land banks as well as to income from mortgages executed to Federal land banks, but you wish to have that confirmed by this office.

"The following provisions of section 26 of the Federal Farm Loan Act of July 17, 1916, 39 Stat. 380, as amended, are pertinent:

> "'* * * First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.'

"As stated in the ruling referred to above, THE EXEMPTION PROVIDED FOR IN SECTION 26 OF THE FEDERAL FARM LOAN ACT IS A CONTINUING EXEMPTION. The income derived from mortgages

(Testimony of A. O. Stewart.)

executed to joint stock land banks which have been sold to individuals IS, THEREFORE, EXEMPT FROM FEDERAL INCOME TAX."

SCOTT W. HOVEY,
General Counsel.
9-12-34
1270

Mr. Harmon: Q. Pursuant to that ruling, Mr. Stewart, I ask you if mortgages were sold to insurance companies, to individuals and other concerns with the representation that income in the form of a discount on those mortgages would be exempt from taxation?

Miss Phillips: Objected to as incompetent, irrelevant and [71] immaterial.

The Court: Objection sustained.

Mr. Harmon: Q. Do you know the purpose, Mr. Stewart, for which that ruling was sought?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Mr. Harmon: I now wish to offer in evidence a copy of the ruling of the Assistant General Counsel of the Bureau of Internal Revenue dated February 28, 1935, which is the original ruling in the particular cases upon which the claims of the petitioners are rejected.

Miss Phillips: No objection. That is an authentic copy.

(Testimony of A. O. Stewart.)

The Court: It may be received.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 10

in evidence.)

[Exhibit No. 10 reads as follows:]

February 28, 1935

GC:I:DAH:PSG

A-280713

In re: A. O. Stewart, et ux.,
Houston, Texas.

Deputy Commissioner Russell:

Reference is made to your memorandum IT:AR:E-1:BAG, requesting an opinion whether profit realized by the above-named taxpayer in the year 1931 on the sale of bonds of joint stock land banks is subject to Federal income tax and whether a loss sustained on the sale of such bonds is deductible. You state that in claiming refunds of tax upon the profits from sale of such bonds taxpayers rely upon the opinion of this office rendered under date of April 3, 1933 in the case of the Des Moines Joint Stock Land Bank, wherein it was held that the discount on the bank's own bonds purchased by it was not taxable to it. (G. C. M. 11726, unpublished).

It does not follow, because a joint stock land bank is exempt from tax upon the income resulting from a purchase of its own bonds, that the profit realized by an individual from a sale of

(Testimony of A. O. Stewart.)

such bonds is not taxable. While the bonds and the income therefrom are by the Farm Loan Act (39 Stat. 360, amended 41 Stat. 1454) declared non-taxable being deemed "instrumentalities of the United States," the individual owners of such bonds are not "Federal agencies" (see Smith v. Kansas City Title & Trust Co. et al., 255 U. S. 180), and with respect to the profits upon sales of the bonds they stand upon the same footing as a seller of State bonds, the interest on which is exempt. Wilcutts v. Bunn, 282 U. S. 216, C. B. X-1, page 309.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the Bureau of
Internal Revenue.

Mr. Harmon: You may take the witness, Miss Phillips.

Cross Examination

Miss Phillips: Q. Mr. Stewart, I understood from your testimony on direct examination that you made your investment in the Kansas City Bank during the summer and fall months of 1930, that is, beginning with July and ending November, 1930, is that correct? A. That is correct.

Q. At that time the Kansas City Bank was in receivership, was it? A. That is correct.

(Testimony of A. O. Stewart.)

Q. It had gone into the hands of a receiver about what year, do you recall? A. In 1927.

Q. And all of its interest was in arrears, was it, since 1927? A. Yes. [72]

Q. It defaulted in its interest when it first went into a receivership?

A. That is the reason it was put in receivership.

Q. Now, you say that you purchased these bonds in reliance upon the various documents which counsel has offered in evidence, beginning with Exhibits 3 and 4 and running on through. Did you actually purchase these bonds, Mr. Stewart?

A. Did I actually purchase them?

Q. Yes, actually have them in your hands?

A. Why, yes.

Q. Isn't it true that you purchased certificates of deposits of somebody else?

A. Well, a certificate of deposit, Miss Phillips, is simply a receipt for the bonds.

Q. That is what I am getting at. Counsel is attempting to prove the foundation of an estoppel. I wanted to find out just what did you buy. Beginning, you say you bought on July 11, 1930. What was the actual thing you bought on that day?

A. Well, I bought both; I bought undeposited bonds and I bought receiver's certificates, which was merely a receipt for the bonds that had been deposited with him.

Q. That is, in some of those dates which you

(Testimony of A. O. Stewart.)

have given beginning in July and ending in November you actually purchased a bond itself with coupons accrued and unaccrued attached?

A. Yes, I did.

Q. And as to those bonds you subsequently turned them into the receiver, did you?

A. I did, yes.

Q. And got a receipt. As to some others you bought from somebody else a receipt showing that that individual had deposited a bond, is that right?

A. Yes.

Q. And you accepted a certificate, a receipt, as showing or in place of the bond itself, is that right?

A. Yes; I could have taken the receipt and gone to the receiver [73] and withdrawn the bonds.

Q. But as it was you accepted a receipt. Could you give us some notion, what sort of a form was it?

Mr. Harmon: Objected to, if your Honor please, as irrelevant and immaterial and not the best evidence.

Miss Phillips: The counsel was attempting to prove the basis of an estoppel here.

The Court: Well, Mr. Stewart has testified that he bought both deposited bonds and undeposited bonds. If some of the bonds were undeposited, of course the framework for the estoppel would exist, wouldn't it, if there is any?

Miss Phillips: Yes. I doubt if there is one, but I would like to find out just what he did buy.

(Testimony of A. O. Stewart.)

The Court: Well, suppose 90 per cent of what he bought were deposited bonds and ten per cent were undeposited bonds?

Miss Phillips: Q. I would like to ask him: Have you any idea what was the percentage of deposited bonds and undeposited bonds you bought?

A. I wouldn't remember that without referring to my books. I don't even know that they would show, because we treated the certificates the same as bonds that were dealt in. They could have been withdrawn.

The Court: Q. But there were some of them undeposited bonds? A. Yes.

Q. That you bought in the open market or from private persons?

A. I would say offhand that there was at least a third.

Miss Phillips: Q. Of undeposited bonds?

A. Of undeposited bonds.

Q. And the remaining two-thirds were of certificates or receipts for a bond? A. Yes. [74]

Q. ——which had previously been deposited, is that right? A. That is correct.

The Court: I suppose that, as a matter of fact, when these liquidation proceedings were initiated there was a direction that bondholders should file their bonds with a trustee, and I suppose when they transferred this—what did you get, a transfer from the depositor of his receipt? Did he hand over his receipt to you, or was his receipt redeposited with

(Testimony of A. O. Stewart.)

the receiver and surrendered to the receiver and a new receipt issued to you?

A. No, your Honor. It just occurs to me now that what I purchased were certificates. These bonds had been deposited with a bondholder's committee, not the receiver—the bondholders' committee that had a plan—that tried to form some plan of reorganization, and that asked for a deposit of bonds. A great many of the bondholders had deposited the bonds with that committee and received a certificate, and others did not file, and those bonds were also sold in the——They sold at the same price as the protective committee's certificates did.

Q. What you bought were the bondholders' protective committee's certificates of deposit?

A. That is correct.

Q. Those were assigned to you? A. Yes.

Q. So far as deposited bonds were concerned, that was the method followed?

A. That was the method followed.

Miss Phillips: Q. If Mr. Jones had deposited his bond you would get his certificate with an assignment on it to you? A. Yes.

Q. Or an assignment in blank—how was it?

A. Well, it was usually assigned in blank.

Q. An assignment in blank? A. Yes. [75]

Q. Would you buy these bonds on an open market, on a stock exchange or through a bank or what?

A. No, they were over the counter transactions.

(Testimony of A. O. Stewart.)

The banks were in receivership; they couldn't have been traded in on the exchange.

Q. Now, with the Milwaukee Bank, what was the situation there?

A. Well, that was in the same category; it has both. They had a protective committee also.

Q. Do you mean in that case you bought certificates of deposit which a former owner had received when he deposited the bonds with the protective committee?

A. Yes, some of them were those certificates and some of them were the actual bonds.

Q. And in that case in some you got actual bonds with the accrued and unaccrued coupons attached and others you got a certificate of deposit which was signed in blank or endorsed to you, or how was it?

A. They were usually signed in blank and you could send over any one and withdraw the actual bonds if you desired.

Q. Are you an accountant, Mr. Stewart?

A. I am not, no.

Q. When you made your statement as to the profits made by these seven or eight joint stock land banks to which your counsel directed his questions in the latter part of your examination, are you relying there on the statements of an accountant as to what the profits were or were not?

A. Oh, no. There is a report that is issued quarterly by the Farm Loan Board—it is now the Farm

(Testimony of A. O. Stewart.)

Loan Credit Administration; the name was changed in '33.—that published the condition of all of these banks, the number of bonds outstanding, the number of mortgages, and by taking the quarterly statements, for [76] instance, from the first one one year to the first of the next year, you could see the number of bonds that had been retired, and by comparing that with the market on the bonds at those various times, it would give you the amount that was made by the bank.

Q. And your conclusion as to the extent of profits made by each of these banks individually to which you testified is drawn from such conclusion or report as that?

A. From that and also from talking with the presidents of the other banks that belonged to the same association we all belong to.

Q. You did not actually go ahead and audit the books of any one of these banks to see what their profit was over and above losses during the particular tax years?

A. Well, these banks—there were no losses, Miss Phillips; in the first place, all of the income of these banks is exempt. It has always been construed to be exempt.

Q. That doesn't answer my question. It is perfectly possible that a farm loan bank may make a bad investment just as any other bank, may have fire insurance not completely covering its fire losses or anything else; any bank can have losses over and

(Testimony of A. O. Stewart.)

above its profit made during a particular year. Now, you have testified that each of these banks made a profit over and above any deductable losses they may have made; that they sustained a profit on their dealings in their own bonds and bonds of other joint stock land banks which was not taxed. Now, I am asking you what is the source of your information for your testimony on that point?

A. Well, the experience of my own bank, for instance. We have paid our stockholders $300 a share; the original investment was $100, so there [77] couldn't be many losses in the bank. That was made from the purchases of the bonds at a discount.

Q. Is your testimony now that these profits are made upon the banks going into liquidation, or was it an ordinary profit made for a particular year?

A. No, these profits were made from the purchases of their bonds at 40 or 50 or 60 cents on a dollar, and that more than offset any losses that the banks sustained in having to take over real estate.

Q. What I am trying to get at is, what is the source of your information and which you have said now that it is from conversation with presidents and other banks and from your conclusions as to the data or figures given in—was it quarterly or annual reports.

A. In the quarterly reports of the Farm Loan Board.

(Testimony of A. O. Stewart.)

Miss Phillips: I think I am almost through, your Honor.

The Court: Q. The bonds of all the joint stock land banks did not sell for 40 or 50 cents on the dollar; some of them went down to 8, 9, 10 and 13.

A. That is true, your Honor.

Miss Phillips: That is all.

The Witness: Some of them went back to 109.

Mr. Harmon: That is all, if your Honor please.

Miss Phillips. Your Honor, I am not offering any testimony. Have you concluded your case?

Mr. Harmon: Yes, except that we have checked the petitions and we find that the matter of estoppel was overlooked, and we want formal leave, if your Honor please, to amend to include a proper allegation to that effect.

The Court: You may have that.

Miss Phillips: May I have the record show an objection [78] to the motion and an exception to your Honor's ruling?

The Court: Yes. Leave to amend the complaint in each case granted. When are you going to file that?

Mr. Harmon: We will try to do that just as soon as possible; within the next day or so.

The Court. Objection by the respondent. Objection overruled. The amendment may be made tomorrow morning at ten o'clock.

Miss Phillips: May I have an exception?

The Court: You may have an exception, and you may have the privilege of amending your answer, if you desire.

Miss Phillips: Thank you, your Honor. I would like to have the record to show a motion——

The Court: Have you rested now?

Mr. Harmon: Yes, your Honor.

The Court: Does the Government rest?

Miss Phillips. I am not offering any evidence. I would like to have the record show a motion for judgment for the defendant on all the issues involved in each case; a further motion for judgment for defendant on the ground that the income derived by the plaintiffs in each of these cases from the sale of, or any dealings in the bonds or the certificates of deposit in each of the joint stock land banks involved in this case on the ground that such income was taxable and was not exempt under the provisions of the law relating to securities issued under the Federal Farm Loan Act.

The Court: The motion will be taken under advisement.

Miss Phillips: Yes, your Honor.

Testimony closed.

(Cause submitted on simultaneous briefs ten days to each side, with seven days for reply briefs.)

[Endorsed]: Filed July 21, 1938. [79]

[Title of District Court and Cause—No. 20379-S.]

NOTICE OF APPEAL

Notice is hereby given that Ashby Oliver Stewart, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on August 20, 1938, and from the whole thereof.

W. GLENN HARMON
ERNEST L. WILKINSON
Attorneys for the appellant
Ashby Oliver Stewart,
206 Sansome Street,
San Francisco, Cal.

[Endorsed]: Filed Nov. 18, 1938. [80]

[Title of District Court and Cause—No. 20379-S.]

BOND ON APPEAL

Whereas a judgment was rendered August 20, 1938, denying the plaintiff herein the refund of taxes, claim for which had been made in the above entitled action as more fully set forth in the complaint therein, and

Whereas, Ashby Oliver Stewart, is dissatisfied with said judgment or order and is desirous of appealing to the Circuit Court of Appeals for the Ninth Circuit.

Now, therefore, in consideration of the premises, the undersigned Fidelity and Deposit Company of Maryland, a body corporate, duly incorporated un-

der the laws of the State of Maryland and authorized to act as Surety, under the Act of Congress approved August 13, 1894, whose principal office is located at Baltimore, State of Maryland, does hereby undertake and promise on the part of the said United States of America, that they will prosecute their said appeal to effect and answer all costs if they fail to make good their plea and appeal, not exceeding the sum of Two Hundred Fifty and no/100 ($250.00) Dollars, to which amount it acknowledges itself justly bound.

And, further, it is expressly understood and agreed that in case of a breach of any condition of the above ob- [81] ligation, the Court in the above entitled matter may, upon notice to the Fidelity and Deposit Company of Maryland, of not less than ten days, proceed summarily in the action or suit in which the same was given to ascertain the amount which said Surety is bound to pay on account of such breach and render judgment therefor against it and award execution therefor.

Dated at San Francisco, California, this 14th day of November, A. D. 1938.

[Seal] FIDELITY AND DEPOSIT COMPANY OF MARYLAND

By GUERTIN CARROLL

Attorney-in-fact

Attest:

G. KEHLENBECK

Attesting Agent

Approved this ..... day of ....., 193....

.....

District Judge.

State of California,
City and County of San Francisco—ss.

On this 14th day of November, A. D. 1938, before me, Charles H. Cunningham, a Notary Public in and for the City and County of San Francisco, residing therein, duly commissioned and sworn, personally appeared Guertin Carroll, attorney-in-fact, and G. Kehlenbeck, Agent of the Fidelity and Deposit Company of Maryland, a corporation, known to me to be the persons who executed the within instrument on behalf of the corporation therein and acknowledged to me that such corporation executed the same, and also known to me to be the persons whose names are subscribed to the within instrument as the attorney-in-fact and Agent respectively of said corporation, and they, and each of them acknowledged to me that they subscribed the name of said Fidelity and Deposit Company of Maryland thereto as principal and their own names as Attorney-in-fact and Agent respectively.

In witness whereof, I have hereunto set my hand and affixed my official seal at my office in the City and County of San Francisco the day and year first above written.

[Seal] CHARLES H. CUNNINGHAM
Notary Public in and for the City and County of San Francisco, State of California.

My Commission expires December 26th, 1938.

The premium charge for this bond is $10.00 per annum.

[Endorsed]: Filed Nov. 18, 1938. [82]

[Title of District Court and Cause—No. 20379-S.]

STIPULATION DESIGNATING THE RECORD ON APPEAL

The plaintiff above named having taken an appeal to the United State Court of Appeals for the Ninth Circuit from the judgment entered herein, and it being the desire of the parties at this time to agree to the parts of the record, proceedings and evidence to be included in the record on appeal,

It is hereby stipulated and agreed that the record on appeal shall consist of the following:

1. The petition of the plaintiff Ashby Oliver Stewart.
2. The answer of the defendant United States of America.
3. The stipulation of facts.
4. Reporter's transcript of the evidence taken at the trial.
5. The opinion of the trial court, which was adopted by the court as findings of fact and conclusions of law; together with the direction for the entry of judgment contained therein.
6. Order of the court amending the findings of fact nunc pro tunc. [83]
7. The judgment entered herein.
8. The notice of appeal filed November 18, 1938.
9. This stipulation.
10. Order transmitting all original exhibits to the Clerk of the Circuit Court of Appeals for the Ninth Circuit, there to be held by him for use in connection with said appeal.

11. The original exhibits filed herein, it being hereby stipulated that all such original exhibits shall be transmitted to the Clerk of the United *States Court* of Appeals for the Ninth Circuit with proper certification thereon by the clerk of this Court, said exhibits to be used on the appeal herein.

Dated at San Francisco, California, December 30, 1938.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Plaintiff-Appellant
FRANK J. HENNESSY
By ESTHER B. PHILLIPS
Attorneys for Defendant-Appellee

[Endorsed]: Filed Feb. 3, 1939. [84]

[Title of District Court and Cause—No. 20379-S.]

ORDER TO TRANSMIT ORIGINAL EXHIBITS TO CIRCUIT COURT OF APPEALS

Upon reading the stipulation of the parties hereto designating the record on appeal, and good cause appearing for this order,

It is ordered that the Clerk of this Court transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit with proper certification, all of the original exhibits offered and

received in the within cause, the same to be used on the appeal of said cause.

Dated this 3rd day of February, 1939.

A. F. ST. SURE
United States District Judge

[Endorsed]: Filed Feb. 3, 1939. [85]

[Title of District Court and Cause—No. 20379-S.]

STIPULATION

It is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that the time for preparing the record in the above entitled cause and the filing and docketing the action with the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit be extended to and including the 10th day of February, 1939.

Dated: San Francisco, California, January 3, 1939.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Plaintiffs-Appellants
FRANK J. HENNESSY
Attorneys for Defendants-Appellees

Upon reading the foregoing stipulation, it is ordered that the same be approved and that the time for preparing the record and filing and docketing

the said cause with the Circuit Court of Appeals for the Ninth Circuit be and it is hereby extended to and including February 10th, 1939.

Dated: San Francisco, California, January 3rd, 1939.

A. F. ST. SURE

District Judge

[Endorsed]: Filed Jan. 3, 1939. [86]

[Title of District Court.]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD ON APPEAL

I, Walter B. Maling, Clerk of the United States District Court, for the Northern District of California, do hereby certify that the foregoing 86 pages, numbered from 1 to 86, inclusive, contain a full, true, and correct transcript of the records and proceedings in the case of Ashby Oliver Stewart, vs. United States of America, No. 20379-S, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of $12.90, and that the said amount has been paid to me by the Attorneys for the appellant herein.

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court, this 10th day of February, A. D. 1939.

[Seal] WALTER B. MALING,
Clerk.

C. C. EVENSEN,
Deputy Clerk.

[87]

[Endorsed]: No. 9100. United States Circuit Court of Appeals for the Ninth Circuit. Ashby Oliver Stewart, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed February 10, 1939.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals for The Ninth Circuit

No. 9100

ASHBY OLIVER STEWART,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS RELIED ON BY APPELLANT ON APPEAL

Comes now the appellant herein, and, pursuant to rule 19, files the following statement of the points upon which he will rely on appeal, and does hereby designate the entire record as being necessary, in his opinion, for the proper consideration of said points.

I. The gains here involved were income derived from Federal farm loan bonds, and as such, exempt from income tax by virtue of the provisions of Section 26 of the Federal Farm Loan Act.

A. The intent of Congress governs as to the tax exemption claimed; and the trial court erred in substituting therefor certain language found in Willcuts v. Bunn, 282 U. S. 216, and in holding that Section 26 was inapplicable because the tax asserted was an excise on "profits from the dealings" or on a "combination of capital, skill and sagacity."

B. The phrase, "income derived therefrom", as understood in ordinary speech, as previously used by Congress, and as construed by judicial decisions, comprehends gains of the type here involved; and Congress in enacting Section 26 is presumed to have employed such meaning.

C. The legislative history of the Federal Farm Loan Act shows Congress intended by Section 26 to exempt gains of the type here involved.

D. Section 26 has been consistently and repeatedly construed by the proper administrative officials to include gains of the type here involved.

E. The well settled administrative construction of Section 26 to the effect that it comprehended gains of the type here involved, has been relied on by taxpayer, and has been accepted and codified by Congress as the law of the land, and is binding.

F. Section 817 of the Revenue Act of 1938, the first and only amendment of Section 26, establishes that the gains here involved are derived from the bonds within the meaning of Section 26.

II. Section 26 of the Federal Farm Loan Act, and not the Revenue Act of 1928, governs the tax exemption here involved.

A. Until the Revenue Act of 1938, there was no express repeal or amendment of Section 26 of the Farm Loan Act.

B. Neither the Revenue Act of 1928 nor earlier revenue acts repealed or amended Section 26 by implication.

C. Well settled administrative construction recognizes that no revenue act (until 1938) amended or superseded Section 26.

D. The aforesaid administrative construction has been relied on by taxpayer and has been accepted and codified by Congress and is therefore binding.

E. Section 817 of the Revenue Act of 1938 conclusively establishes that previous revenue acts have not modified Section 26.

III. The appellee is estopped to assert the tax here involved.

IV. The trial court should have entered judgment against the appellee and in favor of the appellant.

Dated at San Francisco, California, this 9th day of February, 1939.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Appellant.

Copy of foregoing statement of points received this 10th day of February, 1939.

FRANK J. HENNESSY
United States Attorney,
ESTHER B. PHILLIPS
Assistant U. S. Attorney,
Attorneys for Appellee.

[Endorsed]: Filed Feb. 10, 1939. Paul P. O'Brien, Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Excerpt from Proceedings of Wednesday, May 10, 1939

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

Order of submission

Ordered appeal in above cause argued by Mr. W. Glenn Harmon, counsel for appellant, and by Mr. Joseph M. Jones, Special Assistant to the Attorney General, counsel for appellee, and submitted to the court for consideration and decision.

Excerpts from Proceedings of Wednesday, August 30, 1939

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

Order directing filing of opinion and filing and recording of judgment

By direction of the Court, ordered that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

In the United States Circuit Court of Appeals for the Ninth Circuit
No. 9100. Aug. 30, 1939
ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

GARRECHT, Circuit Judge.

During the year 1930 the appellant purchased bonds of the Kansas City Joint Stock Land Bank, issued under the provisions of the Federal Farm Loan Act of 1916, for the sum of $504,275.74. These bonds were of the par value of $886,000, and bore accrued and unaccrued interest coupons. In 1931 the appellant surrendered the said bonds to the receiver of the Kansas City Joint Stock Land Bank and received therefor the sum of $580,636.69.

Prior to 1931 the appellant purchased bonds, with interest coupons

attached, of the Bankers Joint Stock Lank Bank of Milwaukee, issued under the provisions of the said Federal Farm Loan Act, of the par value of $90,000, paying therefor the sum of $19,335. In 1931 the appellant sold said bonds for $27,250.

The total amount received by the appellant from the bonds surrendered to the receiver of the Kansas City Joint Stock Land Bank exceeded the total amount paid therefor by $76,360.95; the total amount received by petitioner and his wife upon the sale of the bonds of the Bankers Joint Stock Land Bank exceeded the amount paid therefor by $7,915. Both banks were in receivership at the time the appellant purchased the bonds and neither was paying interest. The purchases were made for the prospective increment and not for their interest.

From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Land Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds, which contained statements that the bonds and their income were "free from all forms of taxation," including "income tax and all forms of State and municipal tax of every kind and character," etc. Mr. Stewart, acting for himself and his wife, saw and studied these and other circulars, none of which negatived or restricted the language above quoted. He relied upon these statements in making his purchases, reasonably believing he was purchasing securities the profit upon which in case of sale, would be exempt income.

In making his income tax return for the year 1931, the year in question, Stewart divided his income between himself and his wife pursuant to the community property law of the state of California. Identical returns were filed. The appellant managed all business dealings for the community.

Prior to filing income tax returns for 1931, appellant sought a ruling from the Commissioner of Internal Revenue that the income so derived from these bonds was exempt income. The Commissioner ruled it was taxable income and appellant included it in the returns, but simultaneously filed a protest. The appellant paid the tax and made claim for refund, which was rejected.

Complaint for refund of the income tax allegedly erroneously assessed against the appellant was filed in the court below (28 U. S. C. A. § 41 (5) and 20)); judgment was entered in favor of defendant, from which this appeal is taken. The opinion of the court below is reported in 24 F. Supp. 145.

The question presented by this appeal is whether the gain realized upon the surrender and sale of the bonds involved herein is exempt from federal income taxation by reason of Section 26 of the Farm Loan Act of 1916 (39 Stat. 360, 380). As heretofore noted, the bonds in question were issued under the provisions of the Federal Farm Loan Act of 1916, section 26 of which reads in part as follows:

"That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the

income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the *income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation." [Italics supplied.]

The bonds referred to recited:

"This bond is issued under the authority of the Act of Congress approved July 17, 1916, which provides that 'farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation.'"

The applicable provisions of the Revenue Act of 1928, under which the tax complained of was assessed, are set forth in the margin,[1] as is a pertinent provision of the Revenue Act of 1938.

The appellant contends that the gains realized were exempt from income tax by virtue of Section 26 of the Federal Farm Loan Act of 1916, falling within the phrase "income derived therefrom" used in the said section of the Act, and as the word "income" is construed and defined by judicial decisions; that Section 26 was not amended or superseded by the Revenue Act of 1928 or prior revenue laws; that no revenue act until 1938 amended or superseded section 26 of the Act of July 17, 1916.

The appellee argues that gain derived from dealings in bonds is not income derived from the bonds; that the Revenue Act of 1928 exempts from taxation only the interest paid on such bonds; and that the decision of the Supreme Court of the United States in Willcuts v. Bunn, 282 U. S. 216 is controlling. On this case the decision of the court below is based.

---

[1] 45 Stat. 791, 797–798.
"Sec. 22. Gross Income.
"(a) General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
"(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:
* * * * * * *
"(4) Tax-free interest.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. * * *"
52 Stat. 447, 578 (1938):
"Sec. 817. Income from obligations and mortgages issued by joint-stock land banks.
"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation."

The taxpayer is before us claiming an exemption. The rule is that an exemption from taxation is an extraordinary grace of the sovereign and a taxpayer claiming an exemption or deduction must be able to point to an applicable statute and show that he comes within its terms. White, et al. v. U. S., 305 U. S. 281, 292; New Colonial Ice Co. v. Helvering, 292 U. S. 435, 440; Cornell v. Coyne, 192 U. S. 418, 431; Dodge v. Comm'r of Corps. and Taxation (Mass.), 174 N. E. 109, 111. Section 26 of the Farm Loan Act of 1916, supra, relied upon by the taxpayer, specifically states that Federal Farm Loan Bonds "and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, * * *." Eisner v. Macomber, 252 U. S. 189, 207. See Doyle v. Mitchell Brothers Co., 247 U. S. 179, 185; Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 519–520; Taft v. Bowers, 278 U. S. 470, 481; MacLaughlin v. Alliance Ins. Co., 286 U. S. 244, 249. It thus clearly appears that "income" includes both interest and gain realized through dealing in bonds or other property. See Magill, Taxable Income (1936), pp. 17, 70.

In the absence of indication of contrary intention, it is to be assumed that the legislative body gave to the word "income" the common, every-day meaning which the word has been given in the decisions above noted. If the Congress meant "interest," we are confident that word would have been used. The word "interest" is used in Section 22 of the Act not less than 6 times; the same section speaks of the purchase of farm loan bonds at below par, while Section 27 permits Federal Reserve and member banks to buy and sell farm loan bonds. The first sentence of Section 26 exempts every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom from Federal, State, etc., taxes, while the second sentence includes the exemption of bonds, such as those here involved, and the income derived therefrom in the exemption. (The Section is set out supra.) The General Counsel of the Bureau of Internal Revenue rendered an opinion under date of April 3, 1933, in a case involving the Des Moines Joint Stock Land Bank, in the course of which he said: "It would be inconsistent to define the words 'income derived therefrom' found in the third line of section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest." [Tr. 92, Pl. Ex. #6] That reasoning continues sound.

The tax was assessed under the Revenue Act of 1928, which was broad enough to include the tax in question if Section 26 was not controlling (Superintendent v. Commissioner, 295 U. S. 418, 420), and it therefore becomes of importance to inquire whether that act repealed or superseded Section 26 in any manner and, if so, to what extent. Section 22 of the Revenue Act of 1928, heretofore set forth,

provides in subdivision (a) thereof, that "'Gross income' includes gains, profits, and income derived from * * * dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; * * * ." Subdivision (b) (4) of said Section 22 provides, among other things that interest upon "securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended," "shall not be included in gross income and shall be exempt from" income taxation.

There is nothing in Section 22 of the Revenue Act of 1928, so far as is apparent or has been pointed out to us, which indicates an intention on the part of the Congress to repeal or supersede Section 26 of the Farm Loan Act. The Revenue Act of 1928 is a general taxing statute designed to apply generally to the whole field, while the particular sentence of Section 26 of the Farm Loan Act, with which we are concerned, applies specifically to the income derived from farm loan bonds. According to correct rules of statutory construction, the general is not held to supersede the specific in the absence of a definite, expressed intention. No such intent is here expressed. "The cardinal rule is that repeals by implication are not favored." Posadas v. National City Bank, 296 U. S. 497, 503. See also Southeastern Alaska Mining Corp. v. Zavodsky, 9 cir., 60 F. (2d) 24, 25.

"It is a canon of statutory construction that a later statute, general in its terms and not expressly repealing a prior special statute, will ordinarily not affect the special provisions of such earlier statute. In other words, where there are two statutes, the earlier special and the later general—the terms of the general broad enough to include the matter provided for in the special—the fact that the one is special and the other is general creates a presumption that the special is to be considered as remaining an exception to the general, and the general will not be understood as repealing the special, unless a repeal is expressly named, or unless the provisions of the general are manifestly inconsistent with those of the special." Rodgers v. United States, 185 U. S. 83, 87–88. See also Movius v. Arthur, 95 U. S. 144, 146. There is here no irreconcilable conflict; both statutes may be enforced without violence to either. Red Rock v. Henry, 106 U. S. 596, 601–602; Graham & Foster v. Goodcell, 282 U. S. 409, 425–426. "Where both acts are affirmative, and the substance such that both may stand together, both are held to be in force." United States v. Gillis, 95 U. S. 407, 416.

Then, too, we must take into consideration the administrative interpretation, as evidenced by the opinion of the General Counsel of the Bureau of Internal Revenue April 3, 1933, in the Des Moines Joint Stock Land Bank matter, mentioned above, in which he states his conclusion that "income derived therefrom" includes profits or gains.

Moreover, we have the Congress, by Section 817 of the Revenue Act of 1938 (52 Stat. 447, 578), expressly repealing or amending Section 26 of the Farm Loan Act by declaring that "all income, except interest derived" from such bonds, shall be included in gross income.

If such income was taxable despite Section 26 prior to the Revenue Act of 1938, what was the reason for Section 817 of the latter act? The answer is obvious—under the statutes that income was theretofore exempt. Cf. Brewster v. Gage, 280 U. S. 327, 337. In this Section 817 the Congress said what it could have said in 1916 or in 1928, or any year, but did not. The enactment of the act in 1938 was no idle gesture but was necessary to change the proper construction of the law as it stood prior thereto.[3] "This was the explicit and intelligible declaration to which the public was entitled . . . ." when the Congress decided to terminate the exemption theretofore granted. State v. Stoll, 84 U. S. 425, 436. This was the specific amendment or repeal of Section 26 and the attempt to argue that the same result had already been accomplished by the Revenue Act of 1928 is futile.

Satisfied that Section 26 of the Farm Loan Act of 1916 provided for the exemption here claimed and that it was not repealed, amended or superseded by the Revenue Act of 1928, but continued applicable to gains of the type here in question until withdrawn by Section 817 of the Revenue Act of 1938, we pass now to a consideration of the decision of the Supreme Court of the United States in Willcuts v. Bunn, 282 U. S. 216, upon which rested the decision of the court below, and, as well, the argument of the appellee. We would feel constrained to follow the rule of Willcuts v. Bunn, supra, were it not for the difference with respect to facts which requires us to distinguish the instant case from the Willcuts case. To illustrate: In 1919 and 1920 Bunn purchased for cash, as investments, bonds issued by various counties and cities in the state of Minnesota, selling them in January, 1924, and realizing a profit thereon. The Commissioner assessed an income tax upon this net profit, which Bunn paid under protest, later claimed a refund upon the ground that the tax was illegal because assessed upon income from municipal bonds. The claim was rejected and suit brought against the Collector. Demurrer to the complaint was overruled and, defendant having declined to plead further, judgment was entered for plaintiff. The Circuit Court of Appeals affirmed and the Supreme Court granted certiorari. The Supreme Court said at pp. 223, 224, 227, and 228:

"The Revenue Act of 1924 * * * clearly authorized the tax. The Act included in the term 'gross income' the gains and profits derived from 'sales, or dealings in property, whether real or personal.' * * * The Act gave an express exemption to 'interest upon the obligation of a State, Territory or any political subdivision thereof,' but this exemption was not extended to profits realized on the sale of such obligations, * * *

---

[3] "This section subjects to Federal income taxation the capital gain realized by a joint-stock land bank on the purchase of its own obligations or of mortgages made by it. It has been brought to the attention of the committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation, is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint-stock land banks, such income is exempt. The committee is of the opinion that such income ought to be taxed. A similar situation exists with respect to mortgages issued by such banks and acquired at less than cost. For constitutional reasons the provision is confined to gain realized upon bonds and mortgages issued after and acquired after the date of the enactment of the bill." Report of Senate Finance Committee, p. 47.

"The aut[illegible]ority of the Congress to lay a tax on the profit realized by an investor from the sale or conversion of capital assets in general is not open to dispute and is not disputed. * * * The question raised here is not because the securities sold were capital assets but because they were governmental in character.

"* * * The present case is simply one of profit obtained from purchase and sale *without qualification by any special circumstance.* [Italics supplied.]

* * * * * * *

"But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a non-discriminatory excise tax upon the profits derived from the sale of such bonds. The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an 'income tax' and the profits on sales are included in 'income,' the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. [Case cited] The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of caiptal, industry and skill.'"

The decision then goes on to state that a tax upon the profits of such sales did not lay such a burden on the exercise of a State's borrowing power as to make unconstitutional the imposition of an income tax thereon by the Federal Government.

The present case is distinguished from the Willcuts case, in that in the Willcuts case the obligations were those of a State and there was no specific provision of exemption, while in the present case the obligations were issued under a specific statute of the United States which provided for the exemption of income derived therefrom.

Other cases cited by appellee are readily distinguishable. In Igleheart v. Commissioner, 5 cir., 77 F. (2d) 704, 712, Federal Farm Loan Bonds were included in the gross estate of the decedent (Igleheart and others were executors of the estate) subject to the estate tax. The levied and collected tax was not on income; a few lines from the decision will serve to explain the court's position.

"The estate tax is not a tax on property. It is an excise on the privilege of transmitting property of a decedent upon his death; the amount of the tax being measured by the value of the property

transmitted. * * * The provision exempting from taxation Federal Farm Loan bonds and the income therefrom is not violated by measuring the estate tax by the value, at the time of the decedent's death, of all of his property, including such bonds, as the United States may tax the transmission of property upon the death of its former owner, regardless of the character of that property." (Citing Plummer v. Coler, 178 U. S. 115, and Murdock v. Ward, 178 U. S. 139, also cited by the appellee.)

United States Trust Co. of New York v. Commissioner, 2 cir., 98 F. (2d) 734, involved the inclusion in gross estate of proceeds of a War Risk Insurance policy, and there likewise the tax was upon the right to transfer property at death, which is comparable to the Igleheart case immediately above. In Phipps v. Commissioner, 10 cir., 91 F. (2d) 627; Hammersley v. United States, Ct. Cl., 16 F. Supp. 768; and Central Hanover Bank & Trust Co. v. United States, Ct. Cl., 14 F. Supp. 541, the exemption from taxation extended only to principal and interest, not to "income."

While not of importance to the case at hand, it is interesting to note that the Supreme Court of the United States held invalid a recording tax upon mortgages in the state of Alabama, so far as the tax affected mortgages of the Federal Land Banks in that state (Federal Land Bank v. Crosland, 261 U. S. 374) and the District Court of Appeal in California held the State sales tax inapplicable to supplies purchased in that state by the Federal Land Bank (M. G. West Co. v. Johnson, 66 P. (2d) 1211).

Judgment reversed, and cause remanded.

[Endorsed:] Opinion. Filed Aug. 30, 1939. Paul P. O'Brien, Clerk.

Judgment

United States Circuit Court of Appeals for the Ninth Circuit

No. 9100

ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Northern District of California, Southern Division and was duly submitted:

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said District Court.

[Endorsed:] Judgment. Filed and entered August 30, 1939. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 9100

ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Certificate of clerk, U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under Rule 38 of the revised rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing one hundred and forty (140) pages, numbered from and including 1 to and including 140, to be a full, true and correct copy of the entire record excluding original exhibits of the above-entitled cause in the said Circuit Court of Appeals, made pursuant to request of the Honorable Robert H. Jackson, Solicitor General of the United States, counsel for the appellee, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this sixteenth day of January 1940.

[SEAL] PAUL P. O'BRIEN, *Clerk.*

In the Supreme Court of the United States

October Term, 1939

UNITED STATES OF AMERICA

v.

ASHBY OLIVER STEWART

Order extending time within which to apply for a writ of certiorari

On consideration of the motion of counsel for the petitioner in the above-entitled cause, and good cause therefor having been shown, it is now here ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same hereby is extended for a period of sixty (60) days from November 30, 1939.

Dated this 24th day of November 1939.

STANLEY REED,
Associate Justice of the Supreme Court of the United States.

U. S. GOVERNMENT PRINTING OFFICE: 1940

BLANK PAGE

Supreme Court of the United States

Order allowing certiorari

Filed March 25, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1940

BLANK PAGE

FILE COPY

Office Supreme Court, U. S.
FILED
JAN 26 1940
CHARLES ELMORE CROPLEY
CLERK

No. [redacted] 13

In the Supreme Court of the United States

OCTOBER TERM, 1939

UNITED STATES OF AMERICA, PETITIONER,

v.

ARTHUR OLIVER STEWART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BLANK PAGE

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Specification of errors to be urged	3
Reasons for granting the writ	4
Conclusion	5
Appendix A	6
Appendix B	9

CITATIONS

Case:	
Stern Brothers & Co. v. *Commissioner*, decided January 5, 1940	4
Willcuts v. *Bunn*, 282 U. S. 216	3
Statutes:	
Act of March 8, 1938, c. 44, 52 Stat. 107	4
Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360:	
Sec. 26 (U. S. C., Title 12, Sec. 931)	3, 6
Revenue Act of 1916, c. 463, 39 Stat. 756:	
Sec. 2	7
Sec. 4	7
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 22	6
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 817 (U. C. S., Supp. IV, Title 12, Sec. 931a)	8

204767—40

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

ASHBY OLIVER STEWART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in the above cause on August 30, 1939.

OPINIONS BELOW

The opinion of the District Court (R. 36–43) is reported in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals is reported in 106 F. (2d) 405.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 30, 1939. On November 24, 1939, Mr. Justice Reed entered an order

extending the time within which a petition might be filed for a period of sixty days from November 30, 1939. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether gain realized by a taxpayer upon his dealings in bonds issued by joint stock land banks under the Federal Farm Loan Act of 1916 is exempt from federal income taxation.

STATUTES INVOLVED

The statutes involved are set forth in Appendix A, *infra*, pp. 6–8.

STATEMENT

The taxpayer and his wife [1] during the year 1930 purchased farm loan bonds issued under the Federal Farm Loan Act of 1916 by two joint-stock land banks, some of which in the year 1931 they surrendered to the receivers of the issuing banks for liquidation for an amount in excess of what they had paid therefor and the remainder of which they sold for an amount in excess of the purchasing price (R. 36).

The purchases were made for the prospective increment to the bonds and not for the interest therefrom (R. 42).

---

[1] Appellant in No. 9101, below, which case was consolidated with this case, and will be controlled by the final decision herein.

The Commissioner of Internal Revenue ruled that the gain arising from such dealings in the bonds in question, over $84,000 (R. 36), was taxable income. The taxpayer included this income in his tax return for the year 1931, and paid the tax due because of such inclusion. He then filed due claim for refund on the ground that the gain upon disposition of the bonds was exempt from tax under Section 26 of the Federal Farm Loan Act, as amended, which provided that such bonds "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation" (R. 16–19). Upon rejection of the claim for refund (R. 23–25), this suit for refund was instituted.

The District Court determined that the gain so realized was income to the taxpayer and not within the exemption (R. 36–40). The Circuit Court reversed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the gains derived from the dealings in the bonds in question were exempt from federal income tax.

2. In unduly limiting the principles enunciated in *Willcutts* v. *Bunn,* 282 U. S. 216.

3. In reversing the judgment of the District Court and in remanding the case.

4. In failing to sustain the tax upon the gain so derived.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in direct conflict with that of the United States Circuit Court of Appeals for the Eighth Circuit in *Stern Brothers & Co.* v. *Commissioner,* decided January 5, 1940, the opinion in which is reprinted, *infra,* in Appendix B.

2. The Circuit Court has erroneously construed an important federal statute which has not been but should be construed by this Court. While in Section 26 of the Federal Farm Loan Act of 1916, *infra,* Congress used the relatively broader clause exempting the bonds "and the income derived therefrom" instead of the *interest* derived therefrom, it was never intended that gains derived from dealings in the bonds should be exempt. While this statute was prospectively amended in 1938 (Appendix A, *infra,* p. 8), so as to remove any doubt as to the existence of the exemption, the question here presented is nevertheless one of general importance. Not only will a final decision in this case control other pending claims, involving large amounts of money, but it will affect the construction of other recent statutes, such as Section 5 of the Act of March 8, 1938, c. 44, 52 Stat. 107, in which the same broad exemption clause is used, and pursuant to which large numbers of bonds are now being issued.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

JANUARY 1940.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(4) *Tax-free interest.* — Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. * * *

Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360:

SEC. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus

therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation. * * * (U. S. C., Title 12, Sec. 931).

Revenue Act of 1916, c. 463, 39 Stat. 756:

INCOME DEFINED

SEC. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: * * *

SEC. 4. The following income shall be exempt from the provisions of this title:

* * * interest upon the obligations of a State or any political subdivision thereof

or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen; * * *.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 817. INCOME FROM OBLIGATIONS AND MORTGAGES ISSUED BY JOINT-STOCK LAND BANKS.

Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation (U. S. C., Supp. IV, Title 12, Sec. 931a).

APPENDIX B

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 11555—NOVEMBER TERM, A. D. 1939

On Petition to Review Decision of the United States Board of Tax Appeals

STERN BROTHERS & COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(January 5, 1940)

Before STONE, SANBORN, and THOMAS, Circuit Judges

SANBORN, *Circuit Judge,* delivered the opinion of the Court.

This is a petition to review a decision of the Board of Tax Appeals redetermining deficiencies in the income taxes of the petitioner for the years 1934 and 1935. The facts were stipulated. During the years in question the petitioner sold at a profit bonds of Joint Stock Land Banks issued under the Federal Farm Loan Act of July 17, 1916 (c. 245, 39 Stat. 360). Believing that the profits derived from the sale of these bonds were exempt, the petitioner did not include them in taxable income in making its returns. The Commissioner, being of the opinion that these profits were taxable, added

them to the income of the petitioner subject to tax, and proposed deficiencies accordingly. This led to the proceedings before the Board and the decision of which the petitioner now complains.

The sole question presented is whether the profits in suit were nontaxable because of Section 26 of the Farm Loan Act, which, so far as pertinent, provided that bonds issued under the Act "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation" (c. 245, 39 Stat. 380; Tit. 12, U. S. C., § 931). The Board in this case and in the case of *Stewart* v. *Commissioner*, 39 B. T. A. 1103, has ruled that Section 26 did not exempt profits derived from the sale of such bonds. *Stewart* v. *United States*, 24 F. Supp. 145, which was to the same effect, was reversed by the United States Circuit Court of Appeals of the Ninth Circuit in *Stewart* v. *United States*, 106 F. (2d) 405, that court being of the opinion that Section 26 exempted all income from such bonds, including gains derived from the sale thereof. This divergence of informed opinion as to the meaning and scope of Section 26 indicates that the question will not be put to rest until it has been decided by the Supreme Court of the United States.

It would serve no useful purpose to state the contentions of the parties, which are in substance the same as those considered by the Board and by the Circuit Court of Appeals of the Ninth Circuit in the cases referred to, or to express at length our views with respect to the proper construction of Section 26. We offer no criticism of the reasoning

with respect to the meaning of Section 26 upon which the conflicting opinions are based. The judges who decided *Stewart* v. *United States,* 106 F. (2d) 405, were convinced that the language of Section 26 was unambiguous and expressed the intent of Congress that profits derived from the sale of bonds issued under the Act should be nontaxable. Being of that view, they could have reached no other conclusion than that such profits were exempt. On the other hand, a majority of the members of the Board of Tax Appeals were of the opinion that a doubt existed as to the meaning and intent of Section 26, which doubt they were required to resolve in favor of the Government. See *Swan & Finch Co.* v. *United States,* 190 U. S. 143, 146; *Cornell* v. *Coyne,* 192 U. S. 418, 431; *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491.

We think there is a doubt as to whether Section 26 was ever intended to exempt profits derived from the purchase and sale of bonds issued under the Farm Loan Act. We agree that the language of Section 26 is susceptible of a construction which would make such gains nontaxable, but we do not agree that that is the only meaning which may be accorded to the language used. There are several considerations which have influenced us in reaching this conclusion. One is that shortly after having passed the Farm Loan Act, Congress, in enacting the Revenue Act of 1916, provided in Section 4, c. 463, 39 Stat. 756, 758, as follows:

> SEC. 4. The following income shall be exempt from the provisions of this title:
>
> * * * interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under

> the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen; * * *.

This language, was, we think, inserted in the Revenue Act in an attempt to make the exemption therein provided for with respect to the income derived from bonds issued under the Farm Loan Act correspond with the exemption which had already been granted by the terms of Section 26 of that Act, and indicated that Congress did not then regard income derived from the sale of such bonds as having been exempted from taxation. Another consideration is that we can see no practical justification for the granting of such an exemption. The bonds to be issued under the Act were of a character which would normally be attractive to investors, and not to speculators or those who buy securities for the purpose of deriving a profit from their sale. It seems to us that it was the exemption of the income to be derived from investing in and holding such bonds, rather than the exemption of the profits to be derived from buying and selling them, which would make the bonds marketable, and thus be of advantage to those for whose benefit the Farm Loan Act was passed.

The case of *Willcuts* v. *Bunn*, 282 U. S. 216, which is relied upon by the respondent, but which dealt with an implied constitutional immunity from taxation and not with a specific statutory exemption, demonstrates that a gain derived from the sale of a bond which is an instrumentality of government stands in a different situation than the income derived from having and holding such a bond, and is persuasive that Congress might well have intended that the words "income derived therefrom," as

used in Section 26, should be read as covering only such returns as result from the owning and holding of such a bond, and not covering gains derived from its sale. It sometimes happens that a well-founded belief in the existence of an express immunity from taxation proves to be an illusion. *O'Malley* v. *Woodrough*, 307 U. S. 277.

It is our conclusion that there is nothing in the language of Section 26, or in its legislative history, or in the administrative rulings made with regard to it, or in subsequent legislation dealing with the same subject matter, which conclusively establishes that the profits derived by the petitioner from the sale of the bonds in question were nontaxable. We are not convinced that the Board's decision was erroneous.

The order of the Board is

Affirmed.

U. S. GOVERNMENT PRINTING OFFICE: 1940

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
SEP 26 1940
CHARLES ELMORE CROPLEY
CLERK

No. 13

In the Supreme Court of the United States

OCTOBER TERM, 1940

UNITED STATES OF AMERICA, PETITIONER

v.

ASHBY OLIVER STEWART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

BLANK PAGE

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Specification of errors to be urged	3
Summary of Argument	4
Argument:	
Gain upon sale or other disposition of Federal Farm Loan Bonds is not exempt from federal taxation	5
Conclusion	22
Appendix	23

CITATIONS

Cases:	
Agricultural Securities Corporation v. *Commissioner*, 39 B. T. A. 1103	14, 19
Alexander v. *Alexandria*, 5 Cranch 1	11
Bank of Commerce v. *Tennessee*, 161 U. S. 134	21
Bigelow v. *Forrest*, 9 Wall. 339	11
Botany Mills v. *United States*, 278 U. S. 282	21
Burnet v. *Guggenheim*, 288 U. S. 280	11
Central Hanover Bank & Trust Co. v. *United States*, 14 F. Supp. 541, certiorari denied, 300 U. S. 678	16
Cope v. *Cope*, 137 U. S. 682	11
Cornell v. *Coyne*, 192 U. S. 418	21
De Stuers v. *Commissioner*, 26 B. T. A. 201	16
Doyle v. *Mitchell Brothers Co.*, 247 U. S. 179	6
Eisner v. *Macomber*, 252 U. S. 189	6
Flint v. *Stone Tracy Co.*, 220 U. S. 107	16
Graves v. *N. Y. ex rel. O'Keefe*, 306 U. S. 466	7
Greiner v. *Lewellyn*, 258 U. S. 384	15
Hale v. *State Board*, 302 U. S. 95	15, 21
Hamersley v. *United States*, 16 F. Supp. 768, certiorari denied, 300 U. S. 659	15
Hartley v. *Commissioner*, 295 U. S. 216	17
Heiner v. *Colonial Trust Co.*, 275 U. S. 232	21
Helvering v. *Gerhardt*, 304 U. S. 405	21
Helvering v. *Intermountain Insurance Co.*, 294 U. S. 686	21
Helvering v. *New York Trust Co.*, 292 U. S. 455	17, 19

247581—40——1

Cases—Continued. Page

Helvering v. *Twin Bell Syndicate*, 293 U. S. 312 17
Higgins v. *Smith*, 308 U. S. 473 17
Hitner v. *Lederer*, 14 F. (2d) 991, 55 F. (2d) 343, affirmed, 63 F. (2d) 877 16
Hopkins Savings Assn. v. *Cleary*, 296 U. S. 315 11
Igleheart v. *Commissioner*, 77 F. (2d) 704 15
James v. *Commissioner*, 13 B. T. A. 764, affirmed, 49 F. (2d) 707 16
Jordan v. *Roche*, 228 U. S. 436 17
Keifer & Keifer v. *R. F. C.*, 306 U. S. 381 11
Landon v. *Commissioner*, 59 F. (2d) 989, rehearing denied, 61 F. (2d) 1033 8
MacLaughlin v. *Alliance Ins. Co.*, 286 U. S. 244 6
McGuire v. *Commissioner*, 32 B. T. A. 1075 16
Merchants' L. & T. Co. v. *Smietanka*, 255 U. S. 509 6
Murdock v. *Ward*, 178 U. S. 139 14
Mutual Life Ins. Co., v. *Phinney*, 178 U. S. 327 21
Phipps v. *Commissioner*, 91 F. (2d) 627, certiorari denied, 302 U. S. 742 15
Plummer v. *Coler*, 178 U. S. 115 ..... 13, 15
Pollock v. *Farmers' Loan & Trust Co.*, 157 U. S. 429 ..... 7, 9
Roebling v. *Commissioner*, 37 B. T. A. 82 16
Stern Bros. & Co. v. *Commissioner*, 108 F (2d) 309, No. 37, present term 7
Sturm v. *Boker*, 150 U. S. 312 21
Taft v. *Bowers*, 278 U. S. 470 6
Tiger v. *Western Investment Co.*, 221 U. S. 286 11
United States Trust Co. v. *Helvering*, 307 U. S. 57 ..... 14, 21
United States v. *Freeman*, 3 How. 556 11
Weston v. *Charleston*, 2 Pet. 449 7
White v. *United States*, 305 U. S. 281 21
Wilber Nat. Bank v. *United States*, 294 U. S. 120 20
Willcuts v. *Bunn*, 282 U. S. 216 ..... 3, 4, 7, 9, 11, 14
Wilson v. *Commissioner*, 31 B. T. A. 1022 16

Statutes:

Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360:
Sec. 26 (U. S. C., Title 12, Sec. 931) 23
Sec. 3 (U. S. C., Title 12, Secs. 651–664) 20
Revenue Act of 1916, c. 463, 39 Stat. 756:
Sec. 2 10
Sec. 4 11
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 213 11
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 213 11
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 213 11
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 213 11
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 22 ..... 11, 23
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 22 11
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 22 (U. S. C., Title 26, Sec. 22) 11
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 817 (U. S. C. Supp. V, Title 12, Sec. 931a) 17, 24

Miscellaneous: Page

53 Cong. Rec., pp. 7245–7246, 7305–7318, 7375–7378..... 13–14
G. C. M. 11726 (April 3, 1933)..... 13
G. C. M. 14541 (February 28, 1935)..... 18
H. R. 9682, 75th Cong., 3d Sess., Jan. 5 (calendar day April 5) 1938..... 18
H. Rep. No. 704, 73d Cong., 2d Sess., p. 21..... 12
S. Rep. No. 558, 73d Cong., 2d Sess., pp. 23–24..... 12
S. Rep. No. 1567, 75th Cong., 3d Sess., p. 47..... 18

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 13

UNITED STATES OF AMERICA, PETITIONER

v.

ASHBY OLIVER STEWART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 36–43) is reported in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals (R. 128–135) is reported in 106 F. (2d) 405.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 30, 1939. (R. 135.) On November 24, 1939, Mr. Justice Reed entered an order extending the time within which a petition might be filed for a period of sixty days from November

30, 1939. (R. 136.) The petition for a writ of certiorari was filed January 26, 1940, and was granted March 25, 1940. (R. 137.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether gain realized by a taxpayer upon his dealings in bonds issued by joint stock land banks under the Federal Farm Loan Act of 1916 is exempt from federal income taxation.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra,* pp. 22–23.

STATEMENT

The facts, as found by the District Court (R. 36–43), may be summarized as follows:

The taxpayer and his wife [1] during the year 1930 purchased farm loan bonds issued under the Federal Farm Loan Act of 1916 by two joint-stock land banks, some of which in the year 1931 they surrendered to the receivers of the issuing banks for liquidation for an amount in excess of what they had paid therefor and the remainder of which they sold for an amount in excess of the purchase price (R. 36).

---

[1] The taxpayer's wife was appellant in No. 9101, below. Her case was consolidated with this case, and will be controlled by the final decision herein (R. 46).

The purchases were made for the prospective increment to the bonds and not for the interest therefrom (R. 42). In making his purchases, the taxpayer relied upon various statements contained in circulars and bulletins issued by the Federal Farm Loan Board, reasonably believing that he was purchasing securities the profit upon which, in case of sale, would be tax exempt (R. 42–43).

The Commissioner of Internal Revenue ruled that the gain arising from the dealings in the bonds was taxable income (R. 36). The taxpayer included this income in his tax return for the year 1931, and paid the tax due because of such inclusion. He then filed due claim for refund on the ground that the gain upon disposition of the bonds was exempt from tax under Section 26 of the Federal Farm Loan Act, as amended. (R. 16–19.) Upon rejection of the claim for refund (R. 23–25), this suit for refund was instituted.

The District Court determined that the gain so realized was income to the taxpayer and not within the exemption (R. 36–40). The Court of Appeals reversed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the gains derived from the dealings in the bonds in question were exempt from federal income tax.

2. In unduly limiting the principles enunciated in *Willcuts* v. *Bunn*, 282 U. S. 216.

3. In reversing the judgment of the District Court and in remanding the case.

4. In failing to sustain the tax upon the gain so derived.

SUMMARY OF ARGUMENT

Section 22 (a) of the Revenue Act of 1928 expressly includes in gross income gains from dealings in property, while Section 22 (b) (4) excludes from gross income only the interest upon the securities here involved. Hence, taxpayer's gains from dealings in the bonds are subject to income tax unless exempted by Section 26 of the Federal Farm Loan Act of 1916. But that section exempts from taxation only the bonds themselves and "the income derived therefrom". Since the income in question resulted from taxpayer's *dealings* in the bonds, rather than his ownership or possession of them, a distinction recognized as pivotal by this Court in *Willcuts* v. *Bunn,* it may not be said that such income was *derived from* the bonds, and the exemption granted by Section 26 is therefore inapplicable.

Neither the legislative history of Section 26, the administrative interpretation thereof, nor its subsequent amendment, afford any foundation for the conclusion that capital gains from the bonds are tax exempt under Section 26. Indeed, to a considerable extent, they warrant the contrary inference. Moreover, the Government's interpretation is supported by numerous decisions in analogous cases, and by the provisions of all Revenue Acts

since the enactment of the Federal Farm Loan Act of 1916. In any event, however, it is at most doubtful whether the gain in question is comprehended by Section 26, and such uncertainty is fatal to the claimed exemption.

ARGUMENT

GAIN UPON SALE OR OTHER DISPOSITION OF FEDERAL FARM LOAN BONDS IS NOT EXEMPT FROM FEDERAL TAXATION

1. The only question presented in this case is whether the gain upon sale or other disposition[2] of Federal Farm Loan bonds is exempt from federal income taxation. The applicable Revenue Act confers no such exemption, for Section 22 (a) of the Revenue Act of 1928, Appendix, *infra,* includes in gross income "gains, profits, and income derived from * * * dealings in property, whether real or personal", and Section 22 (b) (4) exempts from taxation only the "*Interest* upon * * * securities issued under the provisions of the Federal Farm Loan Act" (italics supplied). If any exemption exists at all, it must stem from Section 26 of the Federal Farm Loan Act of 1916, Appendix, *infra,* which provides that "farm loan bonds

[2] Certain of the bonds were surrendered to the receiver of the issuing bank at a price in excess of what had been paid therefor, while other bonds were sold at a profit (R. 36). Apparently the taxpayer does not contend that such distinction affects the question of tax liability, and neither the District Court nor the Circuit Court of Appeals attributed any significance to it.

247581—40——2

issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the *income derived therefrom* shall be exempt from Federal, State, municipal and local taxation". (Italics supplied.)

The court below held that the gain resulting from dealings in the bonds was "income derived therefrom", and accordingly held the exemption applicable. The reasoning upon which that result appears to have been largely predicated may be stated syllogistically as follows: The word "income", as ordinarily understood and as construed by this Court,[3] is sufficiently comprehensive to include capital gains; Section 26 of the Federal Farm Loan Act of 1916 used the word "income", presumably in its ordinary and accepted significance; hence, the court concluded, it follows that Congress must have intended, by the use of the word "income" in Section 26, to exempt capital gains.

The fallacy in the court's reasoning is this. Section 26 does not exempt simply "income," as the court's reasoning would indicate, nor does it exempt all income with which the bonds are in any manner connected. The exemption is specifically

---

[3] *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, 519–520; *Taft* v. *Bowers*, 278 U. S. 470, 481; *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 249.

limited to the bonds themselves and the "income *derived therefrom*". It is conceded, of course, that the gain realized by the taxpayer was income, but the critical inquiry is whether such income was *derived from the bonds* within the meaning of the statute. We submit that the bonds were involved only indirectly, and that the income in question was derived primarily from the taxpayer's *dealings in the bonds* rather than from mere ownership or possession of the bonds. The Circuit Court of Appeals for the Eighth Circuit so held in *Stern Bros. & Co.* v. *Commissioner,* 108 F. (2d) 309, a case presenting the identical issue.[4]

2. A cognate question was considered by this Court in *Willcuts* v. *Bunn,* 282 U. S. 216. There, a taxpayer who had sold municipal bonds at a profit challenged the validity of the federal tax imposed thereon. This Court held that although a tax on the bonds themselves or on the interest therefrom would be invalid under prior decisions,[5] there was no constitutional inhibition against taxing the profits on sale. The following excerpt from the opinion makes it plain that the bonds are involved

---

[4] Certiorari has been granted in the *Stern Bros.* case, No. 37, present Term, but the case will not be argued, since the parties have stipulated to be bound by the decision in the instant case.

[5] *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; *Weston* v. *Charleston*, 2 Pet. 449. The extent to which these decisions may be relied upon at the present time, however, is perhaps questionable in the light of recent decisions of this Court. Cf., e. g., *Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466.

only indirectly in a tax reaching gain upon sale and that such a tax is not on the bonds or on income derived therefrom (pp. 227–228):[6]

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an "income tax" and the profits on sales are included in "income," the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. * * * The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. *The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as "the creation of capital, industry and skill".* * * * [Italics supplied.]

---

[6] See also *Landon* v. *Commissioner*, 59 F. (2d) 989, rehearing denied, 61 F. (2d) 1033 (C. C. A. 2d).

Thus, it seems clear that this Court in *Willcuts* v. *Bunn* did not regard gain upon sale as income derived from the bonds, for, undoubtedly, the tax would otherwise have been thought to be incompatible with the Court's understanding of *Pollock* v. *Farmers' Loan & Trust Co.* The bonds were involved only indirectly here as well as in *Willcuts* v. *Bunn,* and it seems hardly likely that Congress could have intended to confer tax immunity in these circumstances.

Moreover, the record in the instant case strongly suggests that the income here involved was, in the language of the opinion in *Willcuts* v. *Bunn,* "the *result of the combination of* several factors, including capital investment and * * * some measure of sagacity". The joint stock land banks which had issued the bonds in this case were in receivership at the time the taxpayer purchased the bonds (R. 62). He acquired them at a price substantially below par (R. 60–62). Indeed, about two-thirds of the bonds acquired had been deposited by their owners with protective committees, and the taxpayer obtained them by purchasing the certificates of deposit (R. 110). The taxpayer was or had been an officer in a number of joint stock land banks (R. 58–59), and had apparently made a rather intensive study of their operations and securities (R. 62, 100, 112–113). Although it is true that the record contains no affirmative evidence that the taxpayer was trading on "inside informa-

tion", it seems quite clear that he was strategically situated where he could more readily take advantage of information available to the general public. In the circumstances, it is plain that the profits realized by the taxpayer were the product of capital investment and skill, and flowed only indirectly from the bonds themselves.

3. That Congress did not intend to exempt gain on sale in Section 26 of the Federal Farm Loan Act of 1916 is confirmed by examining the corresponding provisions of the contemporaneously enacted Revenue Act of 1916, c. 463, 39 Stat. 756. Section 2 of that Act provides that "subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from * * * sales, or dealings in property". The pertinent provision of Section 4 exempts only the "*interest* upon * * * securities issued under the provisions of the Federal farm loan Act". (Italics supplied.)

Thus, in spelling out in the Revenue Act the exemption relating to farm loan bonds, Congress declared merely that the interest therefrom was to be exempt. It did not undertake to say that any income arising out of transactions in which the bonds were involved was to be exempt. It specified simply that interest, which springs directly from the bonds, was not subject to tax.

The provisions of the two statutes are unquestionably *in pari materia*,[7] and the Revenue Act was enacted only some two months after the Farm Loan Act, by the same Congress and at the same session. Plainly, the income tax exemption in the Farm Loan Act was not intended to embrace gain on sale.[8]

Similarly indicative of the legislative intention is the fact that each succeeding Revenue Act until 1934 contained a provision identical with the above-quoted clause of Section 4 of the Revenue Act of 1916.[9] And when the language of the exemption was generalized in Section 22 (b) (4) of the Revenue Act of 1934 to include interest from securities issued by any federal corporate instrumentality, it

---

[7] Cognate legislation has often been employed as an aid to statutory construction. *Bigelow* v. *Forrest*, 9 Wall. 339, 350; *Tiger* v. *Western Investment Co.*, 221 U. S. 286, 306; *Cope* v. *Cope*, 137 U. S. 682, 688; *United States* v. *Freeman*, 3 How. 556, 564; *Alexander* v. *Alexandria*, 5 Cranch 1, 7. Cf. *Burnet* v. *Guggenheim*, 288 U. S. 280, 287–288; *Keifer & Keifer* v. *R. F. C.*, 306 U. S. 381; *Hopkins Savings Assn.* v. *Cleary*, 296 U. S. 315, 333–335.

[8] The taxpayer may perhaps contend that, since Congress in granting the exemption contained in Section 26 intended to make federal loan bonds an attractive investment, it must have intended to exempt capital gains as well as interest. The fallacy in this argument lies in the fact that the exemption from taxation of capital gains would, as a necessary concomitant, deprive investors of a deduction for losses on sales. Whether investors would consider it an advantage if both the tax and the deduction were eliminated is, as recognized by this Court, a "matter of mere speculation". *Willcuts* v. *Bunn*, 282 U. S. 216, 231.

[9] Section 213 (b) (4) of the Revenue Acts of 1918, 1921, 1924, 1926, and Section 22 (b) (4) of the Revenue Acts of 1928 and 1932.

is clear that Congress understood the Farm Loan Act as exempting only interest on the bonds from income tax. The Senate Finance Committee made the following statement with respect to the change (S. Rep. No. 558, 73d Cong., 2d Sess., pp. 23–24):

> This is merely a clarifying change made by the House. Under the language of this section, as contained in existing law, *interest* on securities issued under the Federal Farm Loan Act, or such act as amended, is expressly excluded from gross income and thereby made exempt from the income tax. Other acts have been enacted which also exempt the *interest* on obligations issued thereunder from tax. In order to bring the section into accord with the acts authorizing such exemptions and to avoid the necessity of referring to all such acts, a general provision has been inserted by the House excluding from gross income the interest upon the obligations of a corporation organized under act of Congress if such corporation is an instrumentality of the United States; subject to the limitation, however, that the interest is exempt only to the extent provided for in the acts of Congress authorizing the issuance of such obligations. * * * [Italics supplied.]

And the House Ways and Means Committee offered substantially the same explanation. H. Rep. No. 704, 73d Cong., 2d Sess., p. 21.

4. As further evidence of Congressional intention, it should be noted that Section 26 of the Federal Farm Loan Act of 1916 provides that the

bonds and the income derived therefrom were to be exempt from "State, municipal, and local taxation" as well as from federal taxes. But the exemption from state taxation was undoubtedly intended to be merely declaratory of the constitutional immunity that would otherwise exist in the absence of any statutory provision. As this Court said in *Plummer* v. *Coler,* 178 U. S. 115, with respect to a Congressional declaration that certain Government bonds were to be exempt from state taxation "in any form" (p. 118):

> Such a declaration did not operate to withdraw from the States any power or right previously possessed, nor to create, as between the States and the holders of the bonds, any contractual relation. It doubtless may be regarded as a legitimate mode of advising purchasers of such bonds of their immunity from state taxation, and of manifesting that Congress did not intend to waive this immunity * * *.

The exemption from state taxation in the instant case was undoubtedly likewise intended simply to be declaratory of existing constitutional immunity. There is nothing in the legislative history of the applicable provisions which discloses any Congressional purpose to withdraw from the states any power to tax which they had hitherto enjoyed. Indeed, the Congressional debates repeatedly disclose that Congress did not intend the statutory exemption to go beyond existing constitutional limitations. See 53 Cong. Rec., pp. 7245–7246, 7305–

7318, 7375–7378 (64th Cong., 1st Sess.). But it seems clear under the rule of *Willcuts* v. *Bunn* that the states have constitutional power to tax gain on sale of federal bonds in the absence of a Congressional declaration to the contrary. And since the Congressional debates show that Congress did not intend to go beyond the existing limitations, it follows that in exempting the bonds and "income derived therefrom" from state taxation, Congress did not mean to include gain on sale within the words "income derived therefrom". Those words are the identical ones employed in creating the exemption from federal taxation and it should not be presumed, in the absence of evidence to the contrary, that Congress intended them to have a different content for that purpose. *Agricultural Securities Corporation* v. *Commissioner,* 39 B. T. A. 1103, 1109.

5. Broad statutory exemptions from taxation have uniformly been construed as inapplicable where the subject matter of the exemption is involved only indirectly. Thus, in *United States Trust Co.* v. *Helvering,* 307 U. S. 57, proceeds of a war risk insurance policy were held includible in the decendent's gross estate notwithstanding the apparently all-inclusive statutory provision that such insurance "shall be exempt from all taxation". Similarly, a sweeping declaration by Congress that bonds of the United States shall be exempt from "all" taxation was held not to prevent the imposition of an inheritance tax with respect to such bonds. *Murdock* v. *Ward,* 178 U. S. 139. Cf.

Greiner v. *Lewellyn,* 258 U. S. 384; *Plummer* v. *Coler,* 178 U. S. 115. And in *Hale* v. *State Board,* 302 U. S. 95, this Court went so far as to hold that interest from certain municipal bonds might be subjected to a state tax upon net income without violating the contracts clause of the Constitution, in spite of the unqualified statutory exemptions which had declared that such bonds "are not to be taxed" or "shall not be taxed".

Again, in *Hamersley* v. *United States,* 16 F. Supp. 768 (C. Cls.), it was held that the federal gift tax was applicable to a gift of Government bonds notwithstanding the existence of a statutory provision that such bonds should be exempt "both as to principal and interest, from all taxation * * * except * * * estate or inheritance taxes * * *." Th taxpayer had argued that since gift taxes were similar to estate and inheritance taxes, the exclusion of the latter from the exemption was strong evidence that Congress had not intended to exclude gift taxes from the otherwise all-inclusive language of the exemption. Nevertheless, the court construed the statute strictly, and this Court denied certiorari. 300 U. S. 659, rehearing denied, 302 U. S. 774. The same result was reached in *Phipps* v. *Commissioner,* 91 F. (2d) 627 (C. C. A. 10th), certiorari denied, 302 U. S. 742.

Similarly, *Igleheart* v. *Commissioner,* 77 F. (2d) 704 (C. C. A. 5th), held that federal farm loan bonds, the very securities here involved, are includ-

ible in the gross estate despite the provisions of the statute exempting such bonds from federal, state, municipal and local taxation. Gain on the sale of Liberty bonds has been held subject to federal income tax, although the statute under which the bonds were issued provided for their exemption from federal taxation both as to principal and interest. *Central Hanover Bank & Trust Co.* v. *United States,* 14 F. Supp. 541 (C. Cls.), certiorari denied, 300 U. S. 678; cf. *De Stuers* v. *Commissioner,* 26 B. T. A. 201; *Roebling* v. *Commissioner,* 37 B. T. A. 82. And a number of other cases have held in a variety of circumstances that a blanket statutory exemption of Government bonds from taxation did not prevent the imposition of a tax where the bonds were indirectly involved. *Hitner* v. *Lederer,* 14 F. (2d) 991 (E. D. Pa.), 55 F. (2d) 343 (E. D. Pa.), affirmed, 63 F. (2d) 877 (C. C. A. 3d) (salary paid in tax-exempt bonds); *James* v. *Commissioner,* 13 B. T. A. 764, affirmed on other issues, 49 F. (2d) 707 (C. C. A. 2d) (corporate dividends paid in tax-exempt bonds); *McGuire* v. *Commissioner,* 32 B. T. A. 1075, 1088 (same); *Wilson* v. *Commissioner,* 31 B. T. A. 1022, 1029, appeal dismissed (C. C. A. 4th), January 20, 1936 (corporate dividends payable out of interest from tax-exempt bonds). Cf. *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 162 *et seq.*

6. The court below, in sustaining the exemption, relied to a considerable extent upon the amendment of Section 26 of the Federal Farm Loan Act of

1916 by Section 817 of the Revenue Act of 1938,[10] which expressly provides that "all income, except interest" derived from Federal Farm Loan bonds shall be included in gross income. Hence, the Circuit Court of Appeals concluded that, prior to the 1938 enactment, gain such as here involved was exempt. But, as has been recognized by this Court, the specific imposition of a tax in a later Act is not a Congressional declaration that the subject was not taxed theretofore. *Jordan* v. *Roche,* 228 U. S. 436; *Hartley* v. *Commissioner,* 295 U. S. 216, 220–221; *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 322; *Higgins* v. *Smith,* 308 U. S. 473, 479–480. Manifestly, the purpose of an amendment may have been "to clarify what was doubtful and so to safeguard against misapprehension as to existing law". *Helvering* v. *New York Trust Co.,* 292 U. S. 455, 468–469. Indeed, the legislative history of Section 817 does in fact warrant the inference that, insofar as it affects the taxation of capital gains of others than joint stock land banks themselves, its purpose was clarification, rather than change. The Com-

---

[10] Revenue Act of 1938, c. 289, 52 Stat. 452, 578:

"SEC. 817. INCOME FROM OBLIGATIONS AND MORTGAGES ISSUED BY JOINT-STOCK LAND BANKS.

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation." (U. S. C. Supp. V, Title 12, Sec. 931a.)

mittee Report [11] indicates that the purpose of Section 817 was only to subject to tax the capital gains realized by a joint stock land bank on transactions in its own obligations, which in contrast to capital gains realized by other holders were formerly deemed exempt under Section 26 of the Federal Farm Loan Act.[12] Indeed, as originally introduced, Section 817 provided only that such gains by joint stock land banks shall not be tax exempt.[13] And the broadening of the language of the section to cover all profit from dealings in the bonds, by whomever realized, may be presumed to have been made out of an abundance of caution to preclude such subsequent construction of Section 26 as that

---

[11] S. Rep. No. 1567, 75th Cong., 3d Sess., p. 47.

[12] Although the language of Section 26 of the Federal Farm Loan Act does not make any distinction between joint stock land banks and other taxpayers with regard to taxation of the income from the bonds, the Bureau of Internal Revenue ruled that gain realized by a joint stock land bank from dealings in its own bonds was exempt but similar gain was taxable in the case of other taxpayers. G. C. M. 11726 (April 3, 1933), unpublished; G. C. M. 14541 (February 28, 1935), unpublished. Presumably, the exemption which Congress desired to terminate resulted from the construction placed upon Section 26 by the unpublished ruling of April 3, 1933.

[13] The earlier draft appearing as Section 816 read (H. R. 9682, 75th Cong., 3d Sess., Jan. 5 (calendar day April 5), 1938):

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, gain realized on the acquisition by a joint-stock land bank of obligations or mortgages, if such obligations or mortgages are made or issued after the date of the enactment of this Act, shall not be exempt from Federal income taxation."

adopted by the court below. See *Agricultural Securities Corporation* v. *Commissioner,* 39 B. T. A. 1103, 1113.

7. The court below (R. 132) further relied upon an alleged administrative interpretation of Section 26 of the Federal Farm Loan Act of 1916 embodied in the unpublished memorandum of the General Counsel of the Bureau of Internal Revenue of April 3, 1933 (R. 85–93). At the outset, it may be observed that not even published memoranda of this character commit the Department to any interpretation of the law. See *Helvering* v. *New York Trust Co.,* 292 U. S. 455, 468. Moreover, the court below appears to have ignored the fact that the memorandum of April 3, 1933, was concerned solely with whether a *joint stock land bank,* a federal agency, is taxable on gains from transactions in its own bonds. Whatever its reasoning may be thought to imply, that memorandum did not purport to pass upon or even consider the question whether such gains are exempt in the case of taxpayers other than joint stock land banks. When that question was presented, the Bureau specifically and unequivocally ruled that an *individual taxpayer* is taxable on profits resulting from dealings in the bonds. Unpublished memorandum of the Assistant General Counsel for the Bureau of Internal Revenue, February 28, 1935 (R. 106–107).

Similarly, there is no foundation for the taxpayer's so-called "estoppel" argument (Br. in Opp.

11–12) that, regardless of other considerations, the United States is estopped to levy the tax imposed because, as was found by the District Court (R. 42–43), he relied upon certain statements of the Federal Farm Loan Board in buying the bonds, "reasonably believing he was purchasing securities the profit upon which in case of sale, would be exempt income". It does not appear that the statements made (R. 42–43) were any more specific as to the extent of the exemption from income tax than the statute itself. While the statements of the Farm Loan Board were not in all cases identical with the language of the statute, and were sometimes couched in broad and general terms, it was never stated that the income tax exemption extended to capital gains. Nor was the general language of the representations such that the impression would necessarily be conveyed that capital gains were exempt from income tax.[14]

---

[14] In any event, even if the statements of the Federal Farm Loan Board be construed as representing capital gains from dealings in the bonds to be exempt, the United States is not thereby estopped, for the representations, if thus interpreted, were entirely unauthorized. Section 3 of the Federal Farm Loan Act does not, as contended by the taxpayer (Br. in Opp. 11), authorize the representations that capital gains are tax exempt. That section merely provides that "It shall be the duty of the Federal Farm Loan Board * * * to prepare and distribute * * * circulars * * * advising investors of the merits and advantages of farm loan bonds". In the absence of authority from Congress, not even a positive undertaking by administrative officers will preclude the United States from enforcing a public right. *Wilbur Nat. Bank* v. *United States*, 294 U. S.

8. Finally, it is to be observed that the taxpayer is claiming the benefit of an exemption from taxation and that he has at the very most merely cast doubt upon the proper interpretation of the statute. But it is firmly settled that tax legislation must be strictly construed against one claiming a special privilege or exemption thereunder. "There must be no doubt or ambiguity in the language used upon which the claim to the exemption is founded. It has been said that a well founded doubt is fatal to the claim; * * *." *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146. Cf. *Hale* v. *State Board,* 302 U. S. 95, 103; *Helvering* v. *Intermountain Insurance Co.*, 294 U. S. 686, 689; *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235; *United States Trust Co.* v. *Helvering,* 307 U. S. 57, 60; *White* v. *United States,* 305 U. S. 281, 292; *Cornell* v. *Coyne,* 192 U. S. 418, 431. It is our position that the exemption provisions relied upon by the taxpayer are clearly inapplicable here, but that even if any doubt did exist the foregoing decisions would require that doubt to be resolved against the taxpayer.

120, 123; *Botany Mills* v. *United States*, 278 U. S. 282, 289. Moreover, since the question of whether such gain is exempt involves purely a question of law, the taxpayer must be deemed to have relied upon the representations at his peril. *Sturm* v. *Boker*, 150 U. S. 312, 336–337; *Mutual Life Ins. Co.* v. *Phinney*, 178 U. S. 327, 342–343; cf. *Helvering* v. *Gerhardt*, 304 U. S. 405.

247581—40——4

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ARNOLD RAUM,
HOWARD D. PACK,
Special Assistants to the Attorney General.

SEPTEMBER, 1940

APPENDIX

Federal Farm Loan Act, July 17, 1916, c. 245, 39 Stat. 360:

> SEC. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation. * * * [U. S. C., Title 12, Sec. 931.]

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (*a*) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or

the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(4) *Tax-free interest.*—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. * * *

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 817. INCOME FROM OBLIGATIONS AND MORTGAGES ISSUED BY JOINT-STOCK LAND BANKS.

Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation.

[U. S. C. Supp. V, Title 12, Sec. 931a.]

U. S. GOVERNMENT PRINTING OFFICE: 1940

BLANK PAGE

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 6 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

No. [redacted] 13

UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

Brief in Opposition to Petition For Writ of Certiorari

W. GLENN HARMON,
J. EDWARD JOHNSON,
San Francisco, Calif.,

ERNEST L. WILKINSON,
JOHN W. CRAGUN,
Washington, D. C.,

Counsel for Respondent.

BLANK PAGE

INDEX

PAGE

OPINIONS BELOW 1

JURISDICTION 2

QUESTIONS PRESENTED 2

STATUTES INVOLVED 2, 4

STATEMENT OF FACTS 4

ARGUMENT 5

I. In view of the 1938 amendment to Section 26, Farm Loan Act, the case is one of diminishing importance, not justifying the granting of certiorari 5

II. The decision of the Circuit Court of Appeals for the Ninth Circuit is so clearly correct, and the subsequent decision of the Circuit Court of Appeals for the Eighth Circuit, is so clearly erroneous, that this Court should exercise its discretion to deny certiorari ..... 6, *et seq.*

CITATIONS

Alexander v. Mayer, etc., 5 Cranch, 1 8

Branson v. Wirth, 17 Wall. 32 12

Brewster v. Gage, 280 U. S. 327 7

Cooke v. United States, 91 U. S. 389 12

Cope v. Cope, 137 U. S. 682 8

Doyle v. Mitchell Bros. Co., 247 U. S. 179 7

Duval, Rec'r. v. United States, 25 Ct. Cls. 46 12

Eisner v. Macomber, 252 U. S. 189 7

Eager v. United States, 33 Ct. Cls. 336 12

First National Bank v. Missouri, 263 U. S. 640 8

Hays v. Gauley Mountain Coal Co., 247 U. S. 189 7

Hartson v. United States, 21 Ct. Cls. 451 12

Helvering v. R. J. Reynolds Tobacco Co, 306 U. S. 110 7

Joseph Eichelberber & Co. v. Comm'r Int. Rev., (5th C. C. A.), 88 F. (2d) 874 12

PAGES

Knight, Adm'r v. United States, 35 Ct. Cls. 129 ..... 11, 12
Lincoln Chemical Co. v. Edwards, 289 Fed. 458 (C. C. A. 2nd) 7
Lindsey v. Hawes, 2 Black 554 12
Matthews v. McStea, 91 U. S. 7 8
MacLaughlin v. Alliance Ins. Co., 286 U. S. 244 7
Merchants Loan and Trust Co. v. Smietanka, 255 U. S. 509 7
New York, P. & N. R. Co. v. Peninsula Exchange, 240 U. S. 34 8
Pollock v. Farmers Loan and Trust Co., 157 U. S. 429 7
Puerto Rico v. Shell Co., 302 U. S. 253 5
Ritter v. United States, (3d C. C. A.) 28 F. (2d) 265 12
Sarlls v. United States, 152 U. S. 570 8
Stern Bros. v. Commissioner, (8 C. C. A.) 108 F. (2d) 309 6
Swigart v. Baker, 229 U. S. 187 8
Taft v. Bowers, 278 U. S. 470 7
Tiger v. Western Investment Co., 221 U. S. 286 8
United States v. Bank of Metropolis, 15 Pet. 377 12
United States v. Freeman, 3 How. 556 8
United States v. Great No. Ry. Co., (8th C. C. A.) 57 F. (2d) 385, *aff'd* 287 U. S. 144 12
Utah P. & L. Co. v. United States, 243 U. S. 389 11
Utah v. United States, 284 U. S. 534 11
Wilber Nat. Bank v. United States, 294 U. S. 120 11
William C. Atwater & Co. v. United States, (S. D. N. Y., 1936), 18 F. Supp. 564 12
Willcuts v. Bunn, 282 U. S. 216 11
Woodworth v. Kales (6th C. C. A.) 26 F. (2d) 178 12

STATUTES

Act of July 14, 1870, 16 Stat. 272, c. 256, §1 9
Act of March 14, 1900, c. 41, §11, 31 Stat. 45, 48 9
Act of June 28, 1902, c. 1302, §8, 32 Stat. 481, 484 9
Act of August 5, 1909, c. 6, §39, 36 Stat. 11, 117 9

PAGES

Act of June 25, 1910, c. 386, §10, 36 Stat. 814, 817 9

Act of Dec. 23, 1913, c. 6, 38 Stat. 251, 269, §18, 12 U. S. C. §447 9

Act of Dec. 6, 1937, c. 3, 51 Stat. 4, §4, amending Federal Credit Union Act of June 26, 1934, c. 750, 48 Stat. 1216, 1222, 12 U. S. C. 1768 9

Bankhead-Jones Farm Tenant Act of July 22, 1937, c. 517, 50 Stat. 522, 527, Title IV, §40(i), 7 U. S. C. §1014(i) 9

Farm Credit Act of June 16, 1933, c. 98, 48 Stat. 257, 267, §63, 12 U. S. C. §1138c 10

Farm Loan Act of July 17, c. 245, 39 Stat. 360, 380, §26, 12 U. S. C. §931 ..... 2, 5, 6, 10

§3, 12 U. S. C. §664 ..... 3, 11

Federal Crop Ins. Act of Feb. 16, 1938, c. 30, 52 Stat. 31, 75, §511 of Title V, 7 U. S. C. §1511 9

Federal Deposit Ins. Corp., Act of June 16, 1933, c. 89, 48 Stat. 162, 168, 177, §8 [§12B(p)], 12 U. S. C. §264(p) 10

Federal Deposit Ins. Act as amended by Banking Act of 1935, c. 614, 49 Stat. 684, 696, §101 [§12 B(*l*)(9)], 12 U. S. C. 264 (*l*)(9) 9

Federal Home Loan Bank Act of July 22, 1932, c. 522, 47 Stat, 725, 735, §13, 12 U. S. C. §1433 10

Federal Savings and Loan Insurance Corporation Act of June 27, 1934, c. 847, 48 Stat. 1246, 1257, §402(e), 12 U. S. C. §1725(e) 10

Federal Reserve Act of Dec. 23, 1913, c. 6, 38 Stat. 251, 258, §7, 12 U. S. C. §531 ..... 9, 10

First Liberty Loan Act of April 24, 1917, c. 4, 40 Stat. 35, §1, 31 U. S. C. §746 9

Fourth Liberty Loan Act of July 9, 1918, c. 142, §3, 40 Stat. 844, 845, 31 U. S. C. §750 9

Home Owners' Loan Act of June 13, 1933, c. 64, 48 Stat. 128, 130, §4(c), 12 U. S. C. §1463(c) 10

PAGES

National Mortgage Associations Act of Feb. 3, 1938, c. 13, 52 Stat. 8, 24, §8, 12 U. S. C. §1722 10

Reconstruction Finance Corporation Act of Jan. 22, 1932, c. 8, 47 Stat. 5, 9, §10, 15 U. S. C. §610 10

Revenue Act of 1928, §22, 45 Stat. 791 ..... 3, 4, 5

Revenue Act of 1938, §817, 12 U. S. C. §931(a) 3, 5, 8

Second Liberty Loan Act of Sept. 24, 1917, c. 56, 40 Stat. 288, 291, §7, 31 U. S. C. §747 9

Third Liberty Loan Act of April 4, 1918, c. 44, 40 Stat. 502, 31 U. S. C. §747 9

United States Housing Act of 1937, c. 896, 50 Stat. 888, 890, 898, §§5(e), 20(b), 42 U. S. C. §§1405(e), 1420(b) 10

Victory Liberty Loan Act of March 3, 1919, c. 100, §1, 40 Stat. 1309, 1310, 31 U. S. C. §753(b) 9

War Finance Corporation Act of April 5, 1918, 40 Stat. 506, 511, c. 45, §§16, 17, 15 U. S. C. §§344, 345 10

MISCELLANEOUS

Department of Justice, *"Taxation of Government Bondholders and Employees—The Immunity Rule and the 16th Amendment,"* Gov. Printing Office, 1938 7

H. R. Doc. 679, 63rd Congress, 2nd Session 10

Hearings before Sub-Committee, Committee on Banking and Currency, Senate and House on Rural Credits, 63rd Congress, 2nd Session 11

Senate Report 1567, 75th Congress, 3rd Session 8

Senate Document 380, 63rd Congress, 2nd Session 11

Congressional Record, Vol. 53, pp. 7128, 7511 11

Vol. 83, 6765, 6504 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

No. 675

UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

BRIEF IN OPPOSITION

To Petition for Writ of Certiorari to the Circuit Court of Appeals for the Ninth Circuit.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Opinions Below

The opinion of the District Court (R. 36-43) is reported in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals (R. 128-136) is reported in 106 F. 2d 405.

Jurisdiction

The judgment below was entered August 30, 1939. R. 135. Time within which the petition might be filed was extended by Mr. Justice Reed for a period of sixty days from November 30, 1939. R. 136. The petition was filed on January 26, 1940. Jurisdiction is invoked under §240(a) of the Judicial Code.

Questions Presented

1. Whether income derived from Federal farm loan bonds through the surrender of those bonds to the receiver of the issuing bank for an amount in excess of the amount paid for them, is exempt from income tax by reason of Section 26 of the Farm Loan Act of July 17, 1916 (Title 12 U. S. C. §931) exempting from tax the bonds "and the income derived therefrom."

2. Whether income derived from Federal farm loan bonds through the sale of such bonds on the market for an amount in excess of the amount paid for them, is exempt from income tax by reason of Section 26 of the Farm Loan Act.

3. Whether petitioner is estopped to assert taxability of the income involved, by reason of the representations of an agency of petitioner authorized to make such representations, on which respondent relied.

Statutes Involved

Section 26 of the Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat. 360, 380, §26, 12 U. S. C. §931, provides:

> "That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of

> section eleven and section thirteen of this Act. First mortgages executed to Federal land banks or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such *they and the income derived therefrom* shall be exempt from Federal, State, municipal and local taxation." (Italics added.)

Section 3 of the Farm Loan Act, *supra,* (12 U. S. C. §664) provides in part:

> "It shall be the duty of the Federal Farm Loan Board . . . to prepare and distribute . . . circulars . . . advising investors of the merits and advantages of farm loan bonds; . . ."

The Revenue Act of 1938, c. 289, 52 Stat. 447, 578 (12 U. S. C. §931[a]), provides:

> "Sect[illegible] 817. *Income from Obligations and Mortgages Issued by Joint-Stock Land Banks.* Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, *all income, except interest, derived therefrom* shall be included in gross income and shall not be exempt from Federal income taxation." (Italics added.)

The Revenue Act of 1928 provided (c. 852, 45 Stat. 791, 797):

> "Section 22. (a) "'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

"(b) EXCLUSIONS FROM GROSS INCOME. . . .

"(4) TAX-FREE INTEREST.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions . . ."

Statement of Facts

This is an action brought in the United States District Court for the Northern District of California, Southern Division, to recover for an overpayment of taxes by respondent Stewart for the taxable year 1931. The facts found concurrently below may be summarized as follows:

Respondent, for himself and wife, during the year 1930, purchased at below par farm loan bonds issued under the Federal Farm Loan Act of 1916 by the Kansas City Joint Stock Land Bank, and in the following year, 1931, surrendered said bonds to the receiver of the issuing bank for an amount in excess of what he paid therefor, by $76,360.95, but the sale price still being below par. R. 36, 41. Respondent also, during 1930, purchased at below par bonds issued under the same act by the Bankers' Joint Stock Land Bank of Milwaukee, which in 1931 he sold for an amount in excess of what he had paid therefor by $7,915. R. 36, 41. The total gains derived from the bonds in the two transactions were $84,275.95. R. 31-32.

From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Loan Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds, which contained statements that the bonds and their income were "free from all forms of taxation," including "income tax and all forms of State and municipal tax of every kind and character," etc. Respondent saw and studied

these and other circulars, none of which negatived or restricted the language above quoted. R. 37, 42-3. He relied upon these statements in making his purchases, reasonably believing he was purchasing securities the income from which, in case of sale or redemption, would be exempt income. R. 42, 66-7. Both issuing banks were in receivership when the bonds were purchased; no interest was being paid by either; and increment was the only form of gain which respondent had in contemplation when he made the purchase. R. 41-2.

The District Court held that the income involved was not exempt from tax, and dismissed respondent's petition. R. 35-43, 24 F. Supp. 145. The Circuit Court of Appeals reversed, R. 128-136, 106 F. 2d 405, holding that Section 26, exempting income derived from the bonds from all taxes, was as broad as the income-tax statute under which the tax had been assessed.

Argument

As is apparent from the adoption of Section 817 of the Revenue Act of 1938, *supra*, the question whether income of the kind involved in this case is expressly exempted from tax by Section 26 of the Federal Farm Loan Act has been settled prospectively from the date of the Revenue Act of 1938. The question as to whether Section 26 of the Federal Farm Loan Act was intended by Congress to exempt such profits is therefore one of diminishing importance.(1)

---

(1) The diminishing importance of the question with reference to the construction of the Federal Farm Loan Act is not controverted by the suggestion of counsel for petitioner (petition, p. 4) that some other statute has used similar language, which may be governed by the decision in this case. For the question of the construction of any particular act is a matter to be established for the particular statute—each law to be construed to effectuate the intent of the lawmakers; "and this meaning in particular instances is to be arrived at not only by a consideration of the words themselves, but by considering, as well, the context, the purposes of the law, and the circumstances under which the words were employed." *Puerto Rico v. Shell Co.*, 302 U. S. 253, 258.

The conflict with the opinion of the court below acknowledged by the Eighth Circuit Court of Appeals in its decision of January 5, 1940 (*Stern Bros. & Co. v. Comm'r Int. Rev.*, 108 F. 2d 309), might be entitled to more weight in this connection were it predicated upon any serious attempt to determine the intent of Congress expressed in Section 26, which, after all, is the decisive factor in this case. Certainly the decision of the Eighth Circuit Court of Appeals wholly fails to consider the mass of evidence, set forth in the opinion of the court below and otherwise available, which shows the intent of Congress to exempt this income. Rather, it resigned to this Court a determination of the question on the ground that it "will not be put to rest until it has been decided by the Supreme Court of the United States." Petn. 10.[1]

Unless there were substantial importance in the case—as manifestly there is not in the light of the 1938 legislation—or unless there were some substantial question as to the correctness of the determination of the court below, we submit that the conflict is not, in the circumstances, one which should commend itself to solution by this Court.

We submit that there is no substantial question with respect to the proposition whether Congress intended by Section 26 of the Federal Farm Loan Act to extend an exemption to income like that taxed herein. Thus, the determination of the court below is supported by the legislative history of the act (R. 131; and see note (1), *infra* p. 11), and by consistent administrative interpretation of the taxing authorities and those administering the Farm Loan Act (R. 42). It had been ruled by the taxing authorities, for instance, with respect to more than $100,000,000.00 of income derived from farm loan bonds through their sale at a

---

(1) At the argument before the Eighth Circuit Court of Appeals, counsel for the Commissioner of Internal Revenue made the *ad hominem* appeal that it was hoped that the court would afford a conflict with the decision of the Ninth Circuit in the present case so that the matter might be brought before this Court.

profit by banks of the Federal farm loan system, that such income was tax exempt by virtue of Section 26. R. 100-101. Specifically, the General Counsel of the Bureau of Internal Revenue held in an opinion that such profits constitute income derived from the bonds and therefore not taxable. R. 85-93, particularly R. 91-92. This was circulated in a letter dated May 2, 1933, to all joint stock land banks by the Federal Farm Loan Board—the agency charged with the administration of the Federal Farm Loan Act. R. 94-5. This administrative interpretation was further confirmed by entering into closing agreements with certain joint-stock land banks in 1936 and 1937, with the approval of the Commissioner of Internal Revenue and the Secretary of the Treasury, exempting from income tax gains exactly like those involved in the present case. R. 98-100. This consistent course of administrative construction, if there were any doubt as to the construction of the statute, would be persuasive as to the correctness of our contention. *Brewster v. Gage,* 280 U. S. 327, 336; *Helvering v. R. J. Reynolds Tobacco Co.,* 306 U. S. 110, 114-115; *Lincoln Chemical Co. v. Edwards,* 289 Fed. 458, 462 (C. C. A. 2d, 1923).

And this construction of the language under consideration is in complete harmony with the interpretation of such language by the courts themselves in construing acts passed at about the same period of time that the Federal Farm Loan Act was adopted. See *Eisner v. Macomber,* 252 U. S. 189, 207; *Merchants Loan and Trust Co. v. Smietanka,* 255 U. S. 509, 520 *et passim*; *Taft v. Bowers,* 278 U. S. 470; *Hays v. Gauley Mountain Coal Co.,* 247 U. S. 189, 192-3; *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179, 185-187. Compare *Pollock v. Farmers Loan and Trust Co.,* 157 U. S. 429; *MacLaughlin v. Alliance Ins. Co.,* 286 U. S. 244, 249, 251; Department of Justice, *Taxation of Government Bondholders and Employees—the Immunity Rule and the 16th Amendment,* Gov. Printing Off., 1938.

The interpretation of the Federal Farm Loan Act by the administrative officials has been ratified and confirmed by Congress, not only in the passage of each Revenue Act since 1916, but also in Section 817 of the Revenue Act of 1938, quoted above, p. 3. Furthermore, the 1938 Act making gains like those here involved subject to the income tax as to obligations issued by joint stock land banks after the date of enactment of that act[1] demonstrates a clear legislative understanding[2] that the words chosen in Section 26 of the Federal Farm Loan Act exempted gains of the kind here involved—as, indeed, except for the ruling with respect to the instant case, had been the consistent understanding of all of the agencies of the government having anything to do with the interpretation of that section. Such interpretation by Congress itself is entitled to great weight. *United States v. Freeman,* 3 How. 556, 564-5; *Alexander v. Mayer, etc.,* 5 Cranch, 1, 7-8; *Matthews v. McStea,* 91 U. S. 7, 12-13; *New York, P. & N. R. Co. v. Peninsula Exchange,* 240 U. S. 34, 39; *Cope v. Cope,* 137 U. S. 682, 688; *Tiger v. Western Investment Co.,* 221 U. S. 286, 309; *First National Bank v. Missouri,* 263 U. S. 640, 658-9; *Swigart v. Baker,* 229 U. S. 187, 197; *Sarlls v. United States,* 152 U. S. 570, 576-7.

A review of exemption statutes generally demonstrates that Congress, in choosing the language it did in the Federal Farm Loan Act in 1916, clearly intended to exempt other income as well as mere interest. Thus, certain acts have limited the ex-

---

(1) The Revenue Act of 1938 states that *"all income, except interest,* derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation."

(2) This understanding was clearly stated by the Senate Committee on Finance, in its report. *Sen. Rep. 1567, 75th Cong., 3d Sess.,* p. 47. It was further explained for the Committee by Senator King, in offering an amendment to the section, which was accepted. 83 *Cong. Rec.* 6765; *cf. id.* p. 6504.

emption to the bonds themselves, *i. e.*, principal.[1] Other statutes, in addition to exempting the bonds themselves, have also granted an exemption to "interest."[2] Other statutes, though not dealing specifically with bonds, have exempted "income derived" from capital, surplus, franchise, reserves, etc.[3] Thus, the Federal

---

(1) Act of March 14, 1900, 31 Stat. 45, 48, §11, authorizing issue of 2% consol bonds.

Act of June 28, 1902, c. 1302, 32 Stat. 481, 484, §8, authorizing 2% Panama Canal toll bonds.

Act of August 5, 1909, c. 6, 36 Stat. 11, 117, §39, authorizing 3% Panama Canal toll bonds.

Act of June 25, 1910, c. 386, 36 Stat. 814, 817, §10, providing for postal savings bonds.

(2) Act of July 14, 1870, c. 256, 16 Stat. 272, §1.

Act of December 23, 1913, c. 6, 38 Stat. 251, 269, §18, 12 U. S. C. §447, providing for issue of Treasury notes and bonds.

First Liberty Loan Act of April 24, 1917, c. 4, 40 Stat. 35, §1, 31 U. S. C. §746.

Second Liberty Loan Act of September 24, 1917, c. 56, 40 Stat. 288, 291, §7, 31 U. S. C. §747.

Third Liberty Loan Act of April 4, 1918, c. 44, 40 Stat. 502, 31 U. S. C. §747 (through amendment of Second Liberty Loan Act).

Fourth Liberty Loan Act of July 9, 1918, c. 142, §3, 40 Stat. 844, 845, 31 U. S. C. §750.

Victory Liberty Loan Act of March 3, 1919, c. 100, §1, 40 Stat. 1309, 1310, 31 U. S. C. §753(b).

(3) Federal Reserve Act of December 23, 1913, c. 6, 38 Stat. 251, 258, §7, 12 U. S. C. §531.

Act creating Federal Deposit Insurance Corporation, June 16, 1933, as amended by Banking Act of 1935, c. 614, 49 Stat. 684, 696, §101 [§12 B (*l*) (9)], 12 U. S. C. §264 (*l*) (9), covering new banks organized by the Federal Deposit Insurance Corporation.

The Bankhead-Jones Farm Tenant Act of July 22, 1937, c. 517, 50 Stat. 522, 527, Title IV, §40(i), 7 U. S. C. §1014(i), relating to the Farmers' Home Corporation.

Act of December 6, 1937, c. 3, 51 Stat. 4, §4, amending Federal Credit Union Act of June 26, 1934, c. 750, 48 Stat. 1216, 1222, 12 U. S. C. §1768.

Federal Crop Insurance Act of February 16, 1938, c. 30, 52 Stat. 31, 75, §511 of Title V, 7 U. S. C. §1511.

Reserve Act, from which Section 26 of the Federal Farm Loan Act was taken,[1] provides:

> "Federal Reserve Banks, including the capital stock and surplus therein and the *income derived therefrom* shall be exempt from Federal, State, and local taxation, except taxes upon real estate." (Section 7; italics added.)

Obviously this language comprehends more than just interest; by virtue of it, gains and profits of every type to Federal Reserve Banks have been considered exempt.

Still other statutes, granting a similar exemption as to capital and surplus, nevertheless exempt only "interest" derived from bonds issued by the particular instrumentality.[2] It is obvious, therefore, that Congress, in choosing the language in the exemption statute here involved, chose language aptly designed to do more than have mere interest exempted. The question posed by the petition is whether the will of Congress, thus clearly ex-

---

(1) Report of the United States Commission, *Sen Doc.* 380, 63rd Cong., 2d Sess., Parts I and II, p. 33; Hearings before Sub-Committee of Committees on Banking and Currency, Senate and House, on Rural Credits, 63rd Cong., 2d Sess., 1914, p. 97; *H. R. Doc.* 679, 63rd Cong., 2d Sess., p. 18.

(2) War Finance Corporation Act of April 5, 1918, 40 Stat. 506, 511, c. 45, §§16, 17, 15 U. S. C. §§344, 345.

Reconstruction Finance Corporation Act of January 22, 1932, c. 8, 47 Stat. 5, 9, §10, 15 U. S. C. §610.

Federal Home Loan Bank Act of July 22, 1932, c. 522, 47 Stat. 725, 735, §13, 12 U. S. C. §1433.

Home Owners' Loan Act of June 13, 1933, c. 64, 48 Stat. 128, 130, §4(c), 12 U. S. C. §1463(c).

United States Housing Act of 1937, c. 896, 50 Stat. 888, 890, 898, §§5(e), 20(b), 42 U. S. C. §§1405(e), 1420(b).

Federal Savings and Loan Insurance Corporation, Act of June 27, 1934, c. 847, 48 Stat. 1246, 1257, §402(e), 12 U. S. C. §1725(e).

Federal Deposit Insurance Corporation, Act of June 16, 1933, c. 89, 48 Stat. 162, 168, 177, §8 [§12B(p)], 12 U. S. C. §264(p).

Farm Credit Act of June 16, 1933, c. 98, 48 Stat. 257, 267, §63, 12 U. S. C. §1138c.

National Mortgage Associations Act of February 3, 1938, c. 13, 52 Stat. 8, 24, §8, 12 U. S. C. §1722.

pressed, and founded on considerations of policy,[1] is to be given force as Congress is clearly shown to have intended, or whether they are to be whittled away by interpretation.

The district court relied on the case of *Willcuts v. Bunn*, 282 U. S. 216. The language relied on has no reference whatever to a situation like that presented by the instant case. That case was adequately distinguished by the court below. R. 133-134. We are here concerned only with finding and applying the intent of Congress in adopting a specific exemption—not with an implied constitutional exemption as was involved in the *Bunn* case.

Furthermore, although the court below did not rule on the contention, it seems apparent that petitioner is estopped to levy the tax imposed. It has been found by the courts below that respondent relied upon the broad statements made by the Farm Credit Administration as to tax exemption of the bonds. The courts below held that respondent reasonably believed from such statements that he was purchasing securities on which the profit in case of sale was exempt. See R. 42. We concede there would be no estoppel if the agents of the United States had no authority to make the representations upon which respondent relied. See *Utah v. United States*, 284 U. S. 534, 545-546; *Utah P. & L. Co. v. United States*, 243 U. S. 389, 408-9, et seq.; *Wilber Nat. Bank v. United States*, 294 U. S. 120, 123. Here, however, there was express authority under §3 of the Federal Farm Loan Act, 12 U. S. C. §664, quoted above, p. 3.

Many cases have held the United States to be estopped on facts no more compelling than those in the instant case. *Knight*,

---

(1) *Sen. Doc. No. 380*, 63rd Cong., 2d Sess., Parts I and II.

Joint Hearings Before Sub-Committee of Committees on Banking and Currency of the Senate and House of Representatives on Rural Credits, 63rd Cong., 2d Sess., pp. 97-98.

Senator Lodge, 53 *Cong. Rec.* 7128; Senator Cummins, 53 *Cong. Rec.* 7511; and various other expressions of committees, persons in charge of the bill, etc.

Adm'r v. United States, (1900), 35 C. Cls. 129, 145; *Duval, Rec'r v. United States,* (1889), 25 C. Cls. 46, 60; *Hartson v. United States,* 21 C. Cls. 451, 456; *United States v. Great No. Ry. Co.,* (8th C. C. A., 1932), 57 F. (2d) 385, 393, aff'd 287 U. S. 144; *Branson v. Wirth,* 17 Wall. 32, 42; *William C. Atwater & Co. v. United States,* (S. D. N. Y., 1936), 18 F. Supp. 564; *United States v. Bank of Metropolis,* 15 Pet. 377, 392; *Joseph Eichelberger & Co. v. Comm'r Int. Rev.,* (5th C. C. A., 1937), 88 F. (2d) 874; *Cooke v. United States,* 91 U. S. 389, 398; *Eager v. United States,* (1898), 33 C. Cls. 336, 338. Cf. *Ritter v. United States* (3d C. C. A., 1928), 28 F. (2d) 265, 267; *Woodworth v. Kales* (6th C. C. A., 1928), 26 F. (2d) 178, 180; *Lindsey v. Hawes,* 2 Black 554, 560.

The petition for certiorari should be denied.

Respectfully submitted,

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

BLANK PAGE

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 8 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner*,

v.

ASHBY OLIVER STEWART, *Respondent*.

BRIEF FOR RESPONDENT.

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

BLANK PAGE

INDEX

	Page
Opinions Below	1
Jurisdiction	1
Questions Presented	2
Statutes Involved	2
Statement of Facts	3
Summary of Argument	5
Argument	7
I. The question is the construction of an express statute and not of an implied exemption	7
A. The function of the Court is to ascertain and enforce the will of Congress	7
B. *Willcuts* v. *Bunn* is inapplicable	8
II. Congress, by enacting Section 26, intended to exempt from taxation all income, including capital gain, having its source in the bonds	11
A. Petitioner's attack upon decision below	11
B. Common understanding of the words "income derived therefrom"	11
C. Internal construction of the Farm Loan Act	16
D. Comparison of Section 26 with other exemption statutes	18
E. Congress had sound reason to exempt capital gains from farm loan bonds from taxation	20
F. Legislative history of Section 26	23
G. Administrative construction of the words "income derived therefrom"	28
H. Legislative construction of Section 26	34
I. Section 26 has not been repealed, amended or interpreted by the Revenue Acts until 1938	40
III. Neither the rule of strict construction nor the argument based on the exemption from state taxation can prevail	44
A. The doctrine of strict construction cannot defeat the exemption	44
B. The argument based on exemption from state taxation is fallacious	47
C. The cases alleged to be analogous are clearly distinguishable	50
IV. Petitioner is estopped to assert the tax	52
V. Conclusion	54

TABLE OF CASES CITED.

Page

Agricultural Securities Corp. v. Commissioner, 39 B. T. A. 1103....23, 30, 50
Alexander v. Mayor, etc., 5 Cranch, 1.... 39
Atwater & Co., William C., v. United States (S. D. N. Y., 1936), 18 F. Supp. 564.... 54
Bank v. Sherman, 101 U. S. 403.... 7
Barber Asphalt v. Denver (8 C. C. A. 1896), 72 Fed. 336.... 39
Black v. Bolen (1920, W. D. Okla.), 268 Fed. 427, writ of error dismissed per cur. (C. C. A. 8, 1921), 277 Fed. 1013.... 53
Blackbird v. Commissioner Int. Rev. (C. C. A. 10th, 1930), 38 F. 2d 976.. 41
Bowers v. West Virginia Pulp & Paper Co., 297 Fed. 225, cert. den., 265 U. S. 584.... 31
Branson v. Wirth, 17 Wall. 32.... 54
Brewster v. Gage, 280 U. S. 327.... 31
Brushaber v. Union Pac. R. Co., 240 U. S. 1....7, 13
Caha v. United States, 152 U. S. 211.... 44
Central Hanover Bank & Trust Co. v. United States (C. Cls), 14 F. Supp. 541, cert. den. 300 U. S. 678.... 51
Charlotte Harbor & N. R. Co v. Welles, 260 U. S. 8.... 34
Citizens Bank v. Parker, 192 U. S. 73....10, 45, 46
Clark v. Bever, 139 U. S. 96.... 7
Cooke v. United States, 91 U. S. 389.... 54
Cope v. Cope, 137 U. S. 682.... 39
Denver & R. G. R. Co. v. United States (1918), 53 C. Cls. 155.... 54
Deputy v. duPont, 308 U. S. 488.... 18
Des Moines Opinion (Ex. 6, R. 85)....17, 29, 31, 32, 33
DeStuers v. Commr., 26 B. T. A. 201.... 51
Dewey v. United States, 178 U. S. 510.... 7
Dick v. Commissioner (C. C. A. 10th, 1935), 76 F. 2d 265, cert. den. 296 U. S. 588.... 41
Doyle v. Mitchell Bros. Co., 247 U. S. 179....13, 14
Duval, Rec'r. v. United States (1889), 25 C. Cls. 46.... 54
Eager v. United States (1898), 33 C. Cls. 336.... 54
Edwards v. Wabash Ry. Co., 264 Fed. 610.... 31
Joseph Eichelberger & Co. v. Comm'r Int. Rev. (5th C. C. A. 1937), 88 F. 2d 874.... 54
Eisner v. Macomber, 252 U. S. 189.... 13
Electric Storage Battery Co. v. Shimadzu, 307 U. S. 5.... 33
Ex parte Crow Dog, 109 U. S. 556.... 40
Farmers', etc. National Bank v. Dearing, 91 U. S. 29.... 39
Federal Land Bank v. Crosland, 261 U. S. 374....47, 50, 52
Federal Trade Commission v. Raladam Co., 283 U. S. 643.... 26
First Natl. Bank v. Missouri, 263 U. S. 640.... 39
French v. Spencer, 21 How. 228.... 7
Frost v. Wenie, 157 U. S. 46.... 40
Gibbons v. District of Columbia, 116 U. S. 404.... 7
Glynn v. United States (1897), 32 C. Cls. 100.... 53
Gould v. Gould, 245 U. S. 151.... 44
Graham v. Goodcell, 282 U. S. 409.... 40
Graves v. People of New York, 306 U. S. 466.... 50
Greiner v. Lewellyn, 258 U. S. 384.... 51
Grosfield v. First National Bank, 73 Mont. 219, 236 Pac. 250.... 44
Hale v. State Board, 302 U. S. 95....9, 51
Hamersley v. United States (C. Cls.), 16 F. Supp. 768.... 51
Hamilton v. Dillin, 21 Wall. 73.... 34
Hamilton v. Rathbone, 175 U. S. 414.... 46
Hartley v. Commissioner, 295 U. S. 216.... 39
Hartson v. United States, 21 C. Cls. 451.... 54
Hassett v. Welch, 303 U. S. 303.... 37

Page

Hayes v. Gauley Mt. Coal Company, 247 U. S. 189 13
Hecht v. Malley, 265 U. S. 144 24
Heinz v. Commr. (3d C. C. A. 1939), 101 F. 2d 453 47
Helvering v. Bliss, 293 U. S. 144 47
Helvering v. Gerhardt, 304 U. S. 405 ..... 50, 53
Helvering v. Gowran, 302 U. S. 238 34
Helvering v. New York Trust Co., 292 U. S. 455 39
Helvering v. R. J. Reynolds Tobacco Co., 306 U. S. 110 31
Helvering v. Stockholms Enskilda Bank, 293 U. S. 84 ..... 44, 45
Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312 39
Helvering v. Winmill, 305 U. S. 79 32
Helvering v. Wood, 309 U. S. 344 20
Higgins v. Smith, 308 U. S. 473 39
Hitner v. Lederer (C. C. A. 3d), 63 F. 2d 877 51
Homeratha v. United States (W. D. Okla., 1930), 40 F. 2d 305, app. dis. (C. C. A. 10th, 1931), 49 F. 2d 1086 41
Humphrey's Executor v. United States, 295 U. S. 602 27
Igleheart v. Commr. (C. C. A. 5th), 77 F. 2d. 704 51
James v. Commr., 13 B. T. A. 764 (C. C. A. 2nd), 49 F. 2d 707 51
Jordan v. Roche, 228 U. S. 436 39
Knight, Adm'r. v. United States (1900), 35 C. Cls. 129 54
Kohlsaat v. Murphy, 96 U. S. 153 ..... 45, 46
Krauthoff v. Kansas City Joint Stock Land Bank (8th C. C. A. 1929), 31 F. 2d 75 47
Lake County v. Rollins, 130 U. S. 662 7
Levy's Lessee v. McCartee, 6 Pet. 102 16
License Tax Cases, 5 Wall. 462 39
Lincoln Chemical Co. v. Edwards, 289 Fed. 458 31
Lindsey v. Hawes, 2 Black 554 54
Lyeth v. Hoey, 305 U. S. 188 7
Lynch v. Alworth-Stephens Co., 267 U. S. 364 18
MacLaughlin v. Alliance Insurance Co., 286 U. S. 244 ..... 8, 15
McCulloch v. Maryland, 4 Wheat. 316 50
McFeely v. Commr., 296 U. S. 102 47
McGuire v. Commr., 32 B. T. A. 1075 51
McNeil v. McNeil, 61 Utah 141, 211 Pac. 988 44
Manhattan Properties v. Irving Trust Co., 291 U. S. 320 33
Silas Mason Co. v. Tax Commissioner, 302 U. S. 186 33
Matthews v. McStea, 91 U. S. 7 39
Mattingly v. District of Columbia, 97 U. S. 687 34
Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509 ..... 13, 14
Mid-Northern Oil Co. v. Walker, 268 U. S. 45 38
Morf v. Bingaman, 298 U. S. 407 40
Movius v. Arthur, 95 U. S. 144 40
Murdock v. Ward, 178 U. S. 139 51
Mutual Life Ins. Co. v. Phinney, 178 U. S. 327 53
National Lead Co. v. United States, 252 U. S. 140 33
New York, P. & N. R. Co. v. Pennsylvania Exchange, 240 U. S. 34 39
Old Colony Railroad Co. v. Commissioner, 284 U. S. 552 16
Old Mission Portland Cement Co. v. Helvering, 293 U. S. 289 33
Osborn v. The Bank, 9 Wheat. 738 46
Owensboro Natl. Bank v. Owensboro, 173 U. S. 664 49
Ozawa v. United States, 260 U. S. 178 7
Phipps v. Commr. (C. C. A. 10th), 91 F. 2d 627, cert. den. 302 U. S. 742 .. 51
Pitman v. Commissioner (C. C. A. 10th, 1933), 64 F. 2d 740 41
Pittman v. H. O. L. C., 308 U. S. 21 ..... 7, 45, 46, 47, 52
Plummer v. Coler, 178 U. S. 115 51
Pompton v. Cooper Union, 101 U. S. 196 39

	Page
Posadas v. National City Bank, 296 U. S. 497	40
Rafferty v. Smith, Bell & Co., 257 U. S. 226	34
Red Rock v. Henry, 106 U. S. 596	40
Ritter v. United States (3d C. C. A., 1928), 28 F. 2d 265	54
Roche's Beach, Inc. v. Commr. (2d C. C. A. 1938), 96 F. 2d 776	47
Rodgers v. United States, 185 U. S. 83	40
Roebling v. Commr., 37 B. T. A. 82	51
Sarlls v. United States, 152 U. S. 570	39
Schuyler Co. v. Thomas, 98 U. S. 169	10
Sessions v. Romadka, 145 U. S. 29	24, 33
Smith v. Kansas City Title & Trust Co., 255 U. S. 180	7, 47, 49, 50
Spencer v. United States (8 C. C. A. 1909), 169 Fed. 562	39
Stanton v. Baltic Mining Co., 240 U. S. 103	7
State v. Stoll, 17 Wall. 425	40
State of Utah v. United States, 284 U. S. 534	52
Staten Island, etc., Co. v. United States (C. C. A. 2d, 1936), 85 F. 2d 68	53
Stern Bros. v. Commissioner Int. Rev. (C. C. A. 8th, 1940), 108 F. 2d 309	2, 11, 18
Stratton's Independence v. Howbert, 231 U. S. 399	13, 14
Sturm v. Boker, 150 U. S. 312	53
Swayne & Hoyt v. U. S., 300 U. S. 297	34
Swigart v. Baker, 229 U. S. 187	39
Taft v. Bowers, 278 U. S. 470	15
Tax Commissioner v. Putnam, 227 Mass. 522	12
Tinco v. Forbes, 228 U. S. 549	34
Tiger v. Western Investment Co., 221 U. S. 286	39
Trinidad v. Sagrada Orden de Predicadores, 263 U. S. 578	47
Union & New Haven Tr. Co. v. Eaton (D. C. Conn. 1927), 20 F. 2d 419	47
United States v. Bank of Metropolis, 15 Pet. 377	54
United States v. Dakota-Montana Oil Company, 288 U. S. 259	32, 33
U. S. v. Freeman, 3 How. 556	38, 45
United States v. Gillis, 95 U. S. 407	40
United States v. Goldenberg, 168 U. S. 94	7
United States v. Great No. Ry. Co. (8th C. C. A. 1932), 57 F. 2d 385, aff'd 287 U. S. 144	54
United States v. Heinszen & Co., 206 U. S. 370	34
United States v. Merriam, 263 U. S. 179	16
United States v. Nix, 189 U. S. 199	40
United States v. Pleasants, 305 U. S. 357	47
United States v. Shreveport Gr. & El. Co., 287 U. S. 77	46
United States v. Stafoff, 260 U. S. 477	41
United States v. Temple, 105 U. S. 97	7
U. S. Trust Co. v. Helvering, 307 U. S. 57	51
Utah v. United States, 284 U. S. 534	52
Utah P. & L. Co. v. United States, 243 U. S. 389	52
Van Allen v. The Assessors, 3 Wall. 573	48
Washington v. Miller, 235 U. S. 422	40
West Co. v. Johnson, 66 P. 2d 1211, cert. den. 302 U. S. 638	52
M. G. West Co. v. Johnson, 66 P. 2d 1211, cert. den. 302 U. S. 638	7
White v. United States (1938), 86 C. Cls. 728, 22 F. Supp. 821	47
White v. United States, 191 U. S. 545	7
White v. United States, 305 U. S. 281	45
Wilber Nat. Bank v. United States, 294 U. S. 120	52
Willcuts v. Bunn, 282 U. S. 216	5, 8, 9, 12, 23, 31, 47, 49, 50
Wilson v. Commr., 31 B. T. A. 1022	51
Wilson v. Shaw, 204 U. S. 24	34
Woodworth v. Kales (6th C. C. A., 1928), 26 F. 2d 178	54
Y. M. C. A. Retirement Fund, Inc. v. Commr. (1929), 18 B. T. A. 139	47

TREATISES AND MISCELLANEOUS AUTHORITIES

Page

Department of Justice, Taxation of Government Bondholders and Employees—the Immunity Rule and the Sixteenth Amendment, Government Printing Office, 198 15
I. T. 2779, XIII-1 CB 41
I. T. 2655, XI-2 CB 41
I. T. 3069, CB 1937-1 41
I. T. 1806, CB II-2 28
Regulations 33, Art. 150 13
Regulations 45, Art. 544 13
Regulations 45, Art. 71 41
Regulations 45, Art. 76 41
Regulations 62, Art. 76 41
Regulations 74, Art. 81 41
Regulations 74, Art. 85-90 41
Regulations 74, Art. 86 41
Regulations 77, Art. 85-90 41
Regulations 77, Art. 51 14
Regulations 77, Art. 86 41
Regulations 101, Art. 22 13
Opinion of General Counsel, Des Moines Joint Stock Land Bank, Ex. 6, R. 85 ..... 17, 29, 31, 32, 33
34 Opp. Atty. Gen. 439, Treas. Decision 3754, IV-2 CB p. 37 41
34 Opp. Atty. Gen. 275, Treas. Decision 3570, III-1 CB p. 85 41
35 Opp. Atty. Gen. 107 41
Paul and Mertens, Law of Federal Income Taxation 44
Yale Law Journal, Vol. 49, p. 352 9

STATUTES, ETC.

Constitution of the United States, 16th Amendment 14, 20
Judicial Code, Sec. 240(a) 2
Federal Farm Loan Act, July 17, 1916, c. 245, 39 Stat. 360, 12 U. S. C.
Generally 27, 32, 35, 42, 47
Sec. 3 ..... 28, 42, 52
Sec. 12 21
Sec. 13 16
Sec. 16 ..... 16, 21
Sec. 21 42
Sec. 22 16
Sec. 26 ..... 2, 4, 5, 6, 7, 10, 11, 16, 27, 28, 32, 34, 37, 38, 39 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 52
Federal Reserve Act, December 23, 1913, c. 6, 38 Stat. 251, 12 U. S. C. §531 ..... 5, 14, 19, 24
Act of July 14, 1870, c. 256, 16 Stat. 272 18
Intermediate Credit Bank, Act of March 4, 1923, c. 252, 42 Stat. 1454 19, 27, 35, 42
Act of May 12, 1933, c. 25, 48 Stat. 46, § 810 ..... 27, 30
Federal Farm Mortgage Corp., Act of January 31, 1934, 48 Stat. 344, as amended, c. 33, 48 Stat. 360, 12 U. S. C. § 1020f 19, 27, 35, 42
Commodity Credit Corp. Act of March 8, 1938, c. 44, 52 Stat. 107 ..... 20, 28
Revenue Act of 1916, c. 463, 39 Stat. 756 43
Sec. 4 41
Sec. 22 40
Revenue Act of 1928, c. 852, 45 Stat. 797:
Sec. 11 51
Sec. 606 29
Revenue Act of 1938, c. 289, 52 Stat. 447, 578, § 817, 12 U. S. C. § 931(a) 3, 6, 27, 34, 37, 36, 39, 43

CONGRESSIONAL REPORTS, ETC.

Congressional Record: Page

Vol. 53 ..... 22, 26, 48
Vol. 83 37
Report of U. S. Commission, Sen. Doc. No. 380, 63d Cong., 2d Sess. 21, 22, 24, 25
Sen. Rep. No. 144, 64th Cong., 1st Sess., Senate Committee on Banking and Currency on Rural Credit 21, 26
Sen. Report 317, 66th Cong., 1st Sess., Committee on Banking and Currency 32
Hearings, Senate, on H. R. 12863, part 2, 65th Cong., 2d Sess. 29
Hearings, Senate Committee on Finance, 75th Cong., 3d Sess. on H. R. 9682 ..... 27, 33, 35
Hearings, Senate Committee on Banking and Currency, 1913-1915, Vol. 35. 25
Joint Hearings before sub-committee of Committee on Banking and Currency of the Senate and House on Rural Credit, 63d Cong., 2d Sess., 1914 ..... 23, 24, 25, 26
S. 289, 64th Cong., 1st Sess. 26
S. 319, 66th Cong., 1st Sess. 32
S. 4061, 63d Cong., 2d Sess. 26
H. R. Doc. 679, 63d Cong., 2d Sess. 21, 22, 24
H. R. Rep. No. 69, Committee on Banking and Currency on Federal Reserve Banks, 63d Cong., 1st Sess. 24
H. R. Rep. No. 630, 64th Cong., 1st Sess., House Committee on Banking and Currency 21
H. R. 630, 64th Cong., 1st Sess. 26
H. R. 15004, 64th Cong., 1st Sess. 26

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

BRIEF FOR RESPONDENT.

OPINIONS BELOW.

The opinion of the District Court (R. 36-43) is reported (although without the additional findings appearing at R. 41-3) in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals (R. 128-135) is reported in 106 F. 2d 405.

JURISDICTION.

The judgment below was entered August 30, 1939. (R. 135.) Time within which the petition might be filed was extended by Mr. Justice Reed for a period of sixty days from November 30, 1939. (R. 136.) The petition was filed on January 26, 1940. Petitioner invoked the jurisdiction

of this Court under § 240(a) of the Judicial Code, upon a conflict of the decision below with a decision in the Eighth Circuit Court of Appeals,[1] and upon a claim of general importance of the question involved. This Court granted the writ of certiorari on March 25, 1940. (R. 137.)

QUESTIONS PRESENTED.

1. Whether income derived from Federal farm loan bonds through the surrender of those bonds to the receiver of the issuing bank for an amount in excess of the amount paid for them, is exempt from income tax by reason of Section 26 of the Farm Loan Act of July 17, 1916 (Title 12 U. S. C. §931) exempting from tax the bonds "and the income derived therefrom".

2. Whether income derived from Federal farm loan bonds through the sale of such bonds on the market for an amount in excess of the amount paid for them, is exempt from income tax by reason of the same section.

3. Whether petitioner is estopped to assert taxability of the income involved, by reason of the representations of an agency of petitioner authorized to make such representations, on which respondent relied.

STATUTES INVOLVED.

Section 26 of the Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat. 360, 380, § 26, 12 U. S. C. § 931, provides in part:

> "That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen

[1] *Stern Bros.* v. *Commissioner Int. Rev.* (C. C. A. 8th, 1940), 108 F. 2d 309.

of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such *they and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation." (Italics added.)

The Revenue Act of 1938, c. 289, 52 Stat. 447, 578, 12 U. S. C. § 931(a), provides:

> "Sec. 817. *Income from Obligations and Mortgages Issued by Joint-Stock Land Banks.* Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, *all income, except interest, derived therefrom* shall be included in gross income and shall not be exempt from Federal income taxation." (Italics added.)

Other related statutes will be found in the Appendix, pp. 1-19.

STATEMENT OF FACTS.

Respondent brought this action in the United States District Court for the Northern District of California, Southern Division, to recover $4,107.76 for an overpayment of taxes made under protest for the taxable year 1931. (R. 2-12) The facts found concurrently below may be summarized as follows:

Respondent, for himself and wife,[2] during 1930, purchased at below par farm loan bonds issued under the Federal Farm Loan Act of 1916 by the Kansas City Joint Stock Land Bank, and in the following year, 1931, surrendered said bonds to the receiver in liquidation of the issuing bank for an amount below par but in excess of what

[2] Respondent's wife is appellant in case No. 9101 below, which was consolidated with this case for trial, and will be controlled by the final decision herein.

he paid by $76,360.95. (R. 30, 31, 36-40.) Respondent also, during 1930, purchased at below par bonds issued under the same act by the Bankers' Joint Stock Land Bank of Milwaukee, which in 1931 he sold for an amount below par but in excess of what he had paid therefore by $7,915. (R. 30, 31, 36-40.) The total gains derived from the bonds in the two transactions were $84,275.95. (R. 31-32.) Both issuing banks were in receivership when the bonds were purchased; no interest was being paid by either; and the purchases were made for the prospective increment and not for their interest. (R. 41-42.)

From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Loan Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds, which contained statements that the bonds and their income were "free from all forms of taxation," including "income tax and all forms of State and municipal tax of every kind and character," etc. Respondent saw and studied these and other circulars, none of which negatived or restricted the language above quoted. (R. 37, 42-3.) He relied upon these statements in making his purchases, reasonably believing he was purchasing securities the income from which, in case of sale, would be exempt income. (R. 42-3.)

The District Court held that the income involved was not exempt from tax. (R. 35-43, 24 F. Supp. 145.) The Circuit Court of Appeals reversed, (R. 128-135, 106 F. 2d 405), holding that Section 26, exempting income derived from the bonds from all taxes, was as broad as the income-tax statute under which the tax had been assessed.

SUMMARY OF ARGUMENT.

I. The primary question is whether Congress by Section 26 of the Farm Loan Act intended to exempt from the income tax capital gains on farm loan bonds. Petitioner should not ask the Court to legislate on this matter, nor to do more than ascertain and give effect to the will of Congress in granting the exemption. The rules as to implied constitutional exemptions, such as were involved in *Willcuts* v. *Bunn*, 282 U. S. 216, have no application where Congress has spoken; for express statutes should be enforced according to the intention of the legislature.

II. If, as petitioner concedes, the word "income" comprehends capital gains, it cannot follow that the phrase "income derived" from farm loan bonds does not include such gains. By the phrase used, Congress pointed out that only such gains (and other income, *i. e.*, interest) as were derived from farm loan bonds, as distinguished from other bonds or investments, should be exempt. That gains on sales of property are in fact derived from the property sold and not from the sale of or dealing in the property (which simply marks the incidence of the tax) has been affirmed by this Court repeatedly. That this concept was incorporated into the Farm Loan Act is shown by (1) the internal construction of the act, its use of the words "income" and "interest," and its recognition that there would be capital gains; (2) a comparison with other exemption statutes, which disclose a discriminating care on the part of Congress to grant exemptions to accord with its policy on the particular subject matter before it; (3) the sound reasons for granting a broader exemption, to give bonds in this new field a competitive advantage over other bonds, and to insure maintenance of the market to effectuate the legislative purpose; (4) the source of the language of the exemption statute—the Federal Reserve Act—where it had originated to give complete exemption from the income tax to Federal reserve banks in all their dealings; (5) the consistent, long-continued administrative construction to the effect that cap-

ital gains are included within the exemption; (6) legislative construction by Congress in § 817, Revenue Act of 1938.

This meaning of Section 26 was not changed by later revenue acts, either through implied repeal or interpretation; for implied repeals are not favored, and there is no evidence that Congress intended either repeal or interpretation. Moreover, consistent administrative construction discloses that Section 26 was never repealed, interpreted or even amended until 1938; that until then it was the sole measure of the exemption granted.

III. The doctrine of strict construction is inapplicable; for just as construing strictly the words levying the tax cannot keep these gains and profits from constituting "income," so construing strictly the words of the exemption clause cannot limit the word "income" so that the phrase means merely "interest derived therefrom." The goal is the intent of Congress. Strict construction is not a substitute for and cannot overbalance other canons such as legislative history, administrative construction and legislative construction.

Petitioner's argument, based on a comparison of the exemption from Federal taxation with the exemption granted from state taxation, is fallacious. Congress has spoken; the question is what it intended, not how far it could go in exempting the bonds from state taxation.

The alleged "analogous cases" relied on by petitioner do not apply; for not one of them involved an exemption statute which was aimed squarely at and designed to defeat the very tax asserted, as here.

IV. Petitioner is estopped to assert the tax. Respondent purchased the bonds for their increment, reasonably believing, in reliance upon representations of the United States, that such capital gains as he might make would be tax-exempt. The agency of petitioner was specifically authorized to make the representations which it did, for the purpose of inducing investors to invest. Petitioner's defense that the representations were of matters of law is beside the point in the circumstances.

ARGUMENT.

I. The Question is the Construction of an Express Statute and Not of an Implied Exemption.

A. The primary question is whether Congress by Section 26 intended to exempt the income here involved. Although this is recognized by petitioner's brief in the implicit admission that Section 26 governs, yet petitioner seeks to apply reasoning and cases quite sterile of help in that direction. Petitioner should realize that "The courts have no function of legislation, and simply seek to ascertain the will of the legislator." *United States* v. *Goldenberg,* 168 U. S. 94, 103; see *Ozawa* v. *United States,* 260 U. S. 178, 194. "It is our business to execute the law as we find it, and not to make or modify it." *Bank* v. *Sherman,* 101 U. S. 403, 406. Congress may grant exemptions in its discretion. *Gibbons* v. *District of Columbia,* 116 U. S. 404, 408; *Brushaber* v. *Union Pac. R. Co.,* 240 U. S. 1; *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103. Accordingly, although there is much current agitation for the elimination of all exemptions, such elimination should come through the regular processes of legislation rather than through judicial legislation; for it is the will of Congress which controls the meaning of taxing statutes and exemptions granted from the tax. *Lyeth* v. *Hoey,* 305 U. S. 188, 194.[3] As to the Farm Loan Act exemption itself, this Court has specifically stated (*Smith* v. *Kansas City Title & Trust Co.,* 255 U. S. 180, 213):

> "With the wisdom and policy of this legislation we have nothing to do. Ours is only the function of ascertaining whether Congress in the creation of the banks, and in exempting these securities from taxation, federal

[3] This elementary doctrine is supported by a mass of additional cases, among which see *Dewey* v. *United States,* 178 U. S. 510, 521; *French* v. *Spencer,* 21 How. 228, 238; *United States* v. *Temple,* 105 U. S. 97, 99; *Clark* v. *Bever,* 139 U. S. 96, 108; *White* v. *United States,* 191 U. S. 545, 551; *Lake County* v. *Rollins,* 130 U. S. 662, 670; *Pittman* v. *H. O. L. C.,* 308 U. S. 21, 32-3; *M. G. West Co.* v. *Johnson,* 66 P. 2d 1211, cert. den. 302 U. S. 638.

> and state, has acted within the limits of its constitutional authority."

B. Petitioner, as did the trial court, has placed its reliance on *Willcuts* v. *Bunn*, 282 U. S. 216,[4] where the taxpayer claimed, by reason of implied constitutional immunity, to be exempt from Federal income tax on capital gains on state bonds. This Court held that such gains were not within the ambit of the implied immunity, saying (p. 231):

> "It must be remembered that we are dealing, not with any express constitutional restriction, *but only with an asserted implication.*" (Italics added.)

That case, as pointed out by the court below (R. 134) was "'without qualification by any special circumstances'," (282 U. S. 224) such as a statute exempting all income derived from the bonds. It involved no consideration of the meaning of the words "income derived therefrom", the very point in dispute in the present case, nor why Congress used the word "income" instead of "interest". It involved no question of the intent of Congress. It cannot, therefore, afford assistance in determining such intent. If that intent was to exempt these gains the *Bunn* case could not change it; conversely, if the intent was not to exempt these gains, the income is taxable for that reason and not because of the *Bunn* case; for whether the tax is leviable or not depends upon the expressed will of Congress and not upon the mere implication of constitutional exemption upon which the *Bunn* case turned.

Nor did the *Bunn* case purport to overrule the long line of decisions hereinafter cited[5] to the effect that capital gains as "income" are derived from capital, a concept reaffirmed in *MacLaughlin* v. *Alliance Insurance Co.*, 286 U. S. 244, a year and a half subsequent to it.

---

[4] The trial court recognized that the *Bunn* case was "not broad enough to constitute an adjudication upon the question immediately confronting us." (R. 37.)

[5] See cases, *infra*, pp. 13-15.

Petitioner places special reliance on the language of the *Bunn* case (pp. 227-8), that a tax upon profits made through purchases and sales of bonds is in effect an excise upon the result of a combination of several factors, including capital investment and quite generally some measure of sagacity, so that the gain may be regarded as "the creation of capital, industry and skill."[6] That language could not possibly have been in the minds of the 1916 Congress when it was creating an entirely new system of rural credit and was confronted with hard realities incident to enticing private investors into a new field. Our concern here is confined to learning what Congress meant in 1916. As this Court said in *Hale* v. *State Board*, 302 U. S. 95, 101:

> "Our search is for something more than the meaning of a property tax or an excise in the thought of skilled economists or masters of finance. It is for the meaning that at a particular time and place and in the setting of a particular statute might reasonably have been accepted by men of common understanding."

---

[6] The opinion of the court below herein was the subject of a comprehensive note in Volume 49, Yale Law Journal, No. 2, December, 1939, p. 352, entitled "Taxation of Capital Gains on Tax Exempt Federal Securities." In discussing the relation of *Willcuts* v. *Bunn* to the present problem, the author said (p. 356):

"The Supreme Court realistically pointed out that capital gain is the final product of at least three factors, 'the creation of capital, industry, and skill,' leaving no doubt that one factor is the bond itself. A literal application of this view to the exempting statute calls at most for segregation of capital gain into taxable and nontaxable proportions, since the operative clause forbids taxation of that portion derived from the bond. The economic absurdity of such a calculation emphasizes the fallacy of applying general language in a remote case to decisions which must be primarily concerned with the meaning of words in a specific context of time and circumstance. Moreover, the status of capital gains in the *Bunn* case, as of 1931, is relevant only so far as it is some evidence of current significance of the term in question, to be weighed in the balance with indications of contemporary Congressional intent."

And in *Citizens Bank* v. *Parker*, 192 U. S. 73, 80:

> "With the wisdom or folly of the charter we have nothing to do. Our sole function is to interpret it. It may seem, in 1903, to have been imprudent legislation. But how did it appear in 1833 and 1836? *We must contemplate it as of that time.*" (Italics added.)

See also *Schuyler Co.* v. *Thomas*, 98 U. S. 169, 172.

Petitioner ignores the fact that the tax here asserted is levied quite apart from skill and sagacity or the steps involved in producing income, just as the exemption from the tax does not depend thereon. There is as much opportunity for the employment of skill and sagacity and "inside information"[7] by Federal land banks, admittedly exempt under the identical phraseology of the first sentence of Section 26, or joint stock land banks held exempt on gains from farm loan bonds under the second sentence,[8] yet that fact has not deprived either of them of the benefits of the exemption. Moreover, in this very case over 90 per cent of the profits were derived from bonds surrendered to the bank receiver in liquidation. The collection of liquidating dividends requires no skill or sagacity.

---

[7] Petitioner intimates (Brief, pp. 9-10) that respondent, while not shown to have been trading on "inside information", was strategically situated more readily to take advantage of information available to the general public, so that the income he derived from the bonds through their sale at a profit was the product not merely of the bonds in which he had invested, but also arose from his skill. The gratuitous suggestion of the use of "inside information" has occurred in this case for the first time in the Government's brief.

[8] Des Moines Opinion, R. 85-93.

II. Congress, by Enacting Section 26, Intended to Exempt from Taxation All Income, Including Capital Gain, Having Its Source in the Bonds.

A. Petitioner seeks to explain syllogistically the decision of the court below, stating that the court thought that since "income" comprehends capital gains, and since Section 26 of the Farm Loan Act exempts "income," it follows that Congress intended to exempt capital gains. Petitioner claims that a fallacy in this argument lies in the fact that the exemption is not merely of "income" but of bonds and the "income derived therefrom". Actually petitioner is completely wrong in contending that the court substituted the word "income" for the phrase "income derived therefrom"; for it gave entire consideration to the interpretation of that phrase and followed the judicial decisions which also considered it (R. 131).[10] Furthermore, if, as now conceded, the word "income" includes capital gains, (Petr.s' Brf., pp. 6, 7, note 3) it is difficult to see how Congress could have more aptly chosen words to exempt such capital gains on farm loan bonds. Apparently, according to petitioner's view, it would be necessary for Congress to exempt the income derived not only from farm loan bonds but from whatever source derived—that is, repeal the income tax on all capital gains—in order to accomplish this result. For if the word "income" includes these gains, then the fact that Congress, to distinguish them from like gains obtained from other bonds (or sources), described them as being derived from farm loan bonds, does not remove them from the scope of such word.

B. By common understanding, profit realized upon the sale or disposal of property is considered to be income

---

[10] It is to be noted that the opinion of the Eighth Circuit Court in the related case, *Stern Bros.* v. *Commissioner* (C. C. A. 8th, 1940), 108 F. 2d 309, which afforded the conflict necessary for review of the problem by this Court, contains no critical analysis either of the intent of Congress or of the meaning of the phrase "income derived therefrom". It did little more than to pass the question to this Court.

derived from that property. Petitioner concedes (Brief p. 7) that the gains in question were income. But petitioner would evade the effect of such concession by denying that the income was derived from the *bonds*, and asserting it came from *dealings* in the bonds. Petitioner completely ignores that it is a stipulated fact that every penny paid to respondent by the receiver of the Kansas City bank was paid "under and pursuant to the covenants contained in said bonds" (R. 31). Respondent controlled neither the time when the bonds were surrendered nor the amount received therefor. Obviously all of it flowed directly from said bonds. The same fact is hardly less evident as to bonds sold on the market; without them there could have been no dealing, no sale, no profit; the bonds were the proximate cause, the very essence of the transactions. The Court in *Wilcutts* v. *Bunn* quoted and cited (282 U. S. 218, 228) with approval *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531, as authority for regarding the gain as "'the creation of capital, industry and skill.'" In that case, the Massachusetts court itself said (p. 529): "The transactions could not be carried out except for the use of capital and the profit is *derived directly from the capital* in combination with skill in selecting time for purchase and for sale." This being true, it would seem that petitioner herein has its causal chain reversed: it is the *dealings* which are indirectly involved in production of this income, if anything, rather than bonds, the latter being directly involved. The gains came to respondent because of his ownership of the bonds and his exercise of one of the principal attributes of ownership. How, then, can petitioner seriously contend that (Petr.'s Brf., p. 7) "the bonds were involved only indirectly," and that the income was derived from "*dealings in the bonds* rather than from mere ownership"? Only by showing that such a contention accorded with the understanding of Congress on the subject,—a showing petitioner does not make.

This Court has entertained no such uncertainty as to the phrase "income derived therefrom" including capital gains. Nor has the Government up until now. In 1913, three years before the passage of the Farm Loan Act, in construing the Excise Tax Act of 1909, this Court ruled that "income may be defined as the gain derived from capital, from labor, or from both combined." *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415. In *Brushaber* v. *Union Pac. R. Co.*, 240 U. S. 1, 16, 17, decided 6 months before enactment of the Farm Loan Act the Court again talked of the "source whence the income was derived." The definition in the *Howbert* case was again reaffirmed in *Doyle* v. *Mitchell Bros. Company*, 247 U. S. 179, 185,[12] some 2 years after the Farm Loan Act, under the Revenue Act of 1916.

In *Eisner* v. *Macomber*, (1920) 252 U. S. 189, pp. 206-7, this Court, in searching for "a clear definition of the term

---

[12] In the *Doyle* case which concerned an excise tax for doing business based upon net income "received by it [taxpayer] from all sources during such year" (Section 38, Excise Tax Act 1909, 36 Stat. 11) the Court refused to permit the Commissioner to include within the measure of the tax accretions to property from the time of its purchase up to January 1st, 1909, and confined the tax to accretions after that date, although the entire amount was received within taxable period. The Court cited and quoted in its opinion and in footnotes several Treasury regulations recognizing a like distinction. See also *Hayes* v. *Gauley Mt. Coal Company*, 247 U. S. 189, which applied the same principle to stock purchased before the act went into effect and sold thereafter. These cases and Treasury regulations clearly recognize that the accretion, although turned into income at one time, nevertheless accrues to the property over the entire period of years it is held and is not derived from the sale or disposal of the property, although realizament in *Merchants Loan & Trust Co.* v. *Smietanka, infra*, quoted in Appendix, pp. 20-23. In accord with this theory, regulations have, since 1916 provided that bond discount should be amortized by the issuer over the life of the bonds rather than accounted for in the year of issue or redemption. Reg. 33, Art. 150. The 1918 regulations provided similarly for both bond premium and bond discount. Reg. 45, Arts. 544 (2)(a), (3)(a); Reg. 101, Art. 22(a)—18 (1938). It would be otherwise if the profit or loss were derived tion then takes place. See also excerpts from brief of the Governfrom the dealings.

'income,' as used in common speech, in order to determine its meaning in the [Sixteenth] Amendment,"[12a] referred to and adopted the definition of income from *Stratton's Independence* v. *Howbert* and *Doyle* v. *Mitchell Bros.*, both *supra*, specifically including therein "profit gained through a sale or conversion of capital assets . . ."[12b] and this Court then said:

> "Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being 'derived,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description." (p. 207.) (Italics by the Court itself.)

Merchants Loan & Trust Co. v. *Smietanka*, 255 U. S. 509, involved the taxability of capital gains under the Revenue Act of 1916 (passed almost concurrently with the Farm Loan Act in 1916). In combating taxpayer's contention that the profit made was so closely related to the capital as to be still a part thereof rather than income, the United States in its brief (Brief for Deft. in Error, No. 608, O. T. 1920, p. 11) asked this question (see Appendix, p. 21): "The question then is, What, in common speech, is under-

---

[12a] The language of Section 26—"income derived therefrom"—stems from the Sixteenth Amendment authorizing taxes upon "income from whatever source derived". The Federal Reserve Act was adopted shortly after the Sixteenth Amendment; and the phrase was used therein to give Federal reserve banks an exemption as broad as the income taxes under the Sixteenth Amendment. See *infra*, pp. 23-24.

[12b] The three classifications of income thus defined by this Court seem to be all-inclusive and have been accepted by the Treasury Department in all of its income tax regulations. Thus Article 51 of Regulation 77 (Revenue Act of 1932) provides that "income is the gain derived from capital, from labor, or from both combined" which includes "profit gained through sale or conversion of capital assets".

stood to be included in income?''; and it answered (pp. 16-17) its own question as follows (Appendix, p. 23):

> ''Income is something separate and distinct from the principal or capital *which produces it.* It is a gain or increase *derived from capital* . . . When property is sold at an advance over what it has cost, the proceeds of sale include both the capital and the income which has resulted . . . *What remains is the income which has been produced by or derived from the capital.''* (Italics added.)

This Court agreed with the analysis of the Government (p. 520):

> '' . . . *it is palpable that it was a 'gain or profit' 'produced by' or 'derived from' that investment,* and that it 'proceeded,' and was 'severed' or rendered severable, from it by the sale for cash, and thereby became that 'realized gain' which had been repeatedly declared to be taxable income within the meaning of the constitutional amendment and the Acts of Congress.'' (Italics added.)

This concept has not been deviated from. In *Taft* v. *Bowers,* 278 U. S. 470, 482, as to property transferred as a gift and thereafter sold by the donee, the increase realized by the sale, the Court said, ''became income *from that investment* in the hands of the recipient . . .'' (Italics added.) And in *MacLaughlin* v. *Alliance Insurance Company,* 286 U. S. 244, 249, 250, decided subsequent to *Willcuts* v. *Bunn,* in construing the 1928 Revenue Act, the Court said:

> ''Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one.''

That the gain came from the sale or dealing, as petitioner now contends, is incompatible with the idea of increase in value to property at any time prior thereto. Compare Department of Justice, *Taxation of Government Bondholders*

and Employees—the *Immunity Rule and the Sixteenth Amendment*, Government Printing Office, 42, 50, 104-5.

It is elementary, of course, that Congress in enacting Section 26 is presumed to have used these words according to their judicial (*United States* v. *Merriam*, 263 U. S. 179, 187) and well-settled meaning. In *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552, 560, this Court said:

> "The rule which should be applied is established by many decisions. 'The legislature must be presumed to use words in their known and ordinary significations.' *Levy's Lessee* v. *M'Cartee*, 6 Pet. 102, 110. 'The popular or received import of words furnishes the general rule for the interpretation of public laws.' *Maillard* v. *Lawrence*, 16 How. 251, 261."

C. This presumption as to the intended meaning of the words is borne out by analysis of the entire Farm Loan Act, which clearly anticipated there would be capital gains. Section 13 (12 U. S. C. § 781, Appendix, p. 2) empowers Federal land banks to buy and sell farm loan bonds, and Section 16 (12 U. S. C. § 813, Appendix, p. 2) extends the same privilege to joint stock land banks; Section 22 (12 U. S. C. § 897, Appendix, p. 4) authorizes the use by both types of banks of certain funds to purchase "at *or below par*" farm loan bonds. Congress used both "interest" and "income" in the Act; the first of these words was used some 41 times in its customary sense as the hiring price of money; the second, however, was used but twice, both times in Section 26. The first sentence of that section provides that "every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and *the income derived therefrom*, shall be exempt from" taxation, etc. There is no question whatever but that as used in this sentence the phrase "income derived therefrom" includes gains and profits of every kind and description, in addition to interest, notwithstanding the fact that these banks and associations must actually purchase and sell in order to realize capital gain, and notwith-

standing the further fact that skill and sagacity, may have played some part therein.

The second sentence, in providing that "farm loan bonds issued under the provisions of this Act * * * shall be deemed and held to be instrumentalities of the United States, and as such they and 'the *income derived therefrom*' shall be exempt from" taxation, etc., used the same precise words, and should therefore also comprehend capital gains. In fact the General Counsel of the Bureau of Internal Revenue so held in the Des Moines opinion, in the course of which he said (Ex. 6, R. 85, 91-92):

> "It would be inconsistent to define the words 'income derived therefrom' found in the third line of Section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest."

Commenting on that language the Circuit Court below said simply: "That reasoning continues sound." (R. 131.) Indeed this meaning was never questioned until the present case arose, and even then the exemption was denied upon a different theory long since exploded and abandoned.[13]

Furthermore, it stands admitted by petitioner herein that the exemption clause of the second sentence of the section is broader than would have been necessary had Congress intended to exempt interest only. See petition for certiorari, page 4:

> "While in Section 26 of the Federal Farm Loan Act of 1916, *infra,* Congress used the *relatively broader clause* [italics added] exempting the bonds 'and the income derived therefrom' instead of the *interest* derived therefrom, it was never intended that gains derived from dealings in the bonds should be exempt."

---

[13] The theory was that respondent could not have the benefit of the exemption even though the bonds and the income derived therefrom were exempt, because he was not himself a "federal agency". See Exhibit 10, R. 106-7. Petitioner has not attempted to sustain this theory in either of the lower courts or here.

What this "relatively broader clause" could possibly include beyond interest unless it be capital gains, petitioner has not shown.[14] It is reasonable to assume that if Congress intended to exempt interest only, it would have very simply said so by using that word. By the same token, it is reasonable to assume that having used the generic term "income" it intended to exempt all income having the bonds as its source. Certainly the efforts of petitioner to limit the scope of the second sentence of Section 26 would require this Court to depart from the rule that the "plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect could discover." *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370; *Deputy* v. *duPont*, 308 U. S. 488, 498.

D. The meaning for which we contend is reinforced by comparing the language of Section 26 with other exemption statutes. Had Congress wanted to exempt only interest on farm loan bonds it had precedent for language to use at least as early as 1870;[15] or it could have followed, even

---

[14] The author of the majority opinion in the related case, *Agricultural Securities Corp.* v. *Commissioner*, 39 B. T. A. 1103, 1107, purported to find justification for the language used through reference to the receivership provisions of the Farm Loan Act in "periodical payments to bondholders resulting from" receivership operations of bank properties. What the Member overlooked was that well over half of the income there involved was of exactly that type, which under his own reasoning was exempt—as would be over 90 per cent of the income involved herein. R. 30-31. Petioner, however, has not adopted that theory. On the contrary, while admitting the breadth of the language used, but remaining silent as to the reason therefor, the Government frankly argued before the Eighth Circuit that "the true and proper construction of the exemption phrase 'they and the income derived therefrom' of the Federal Farm Loan Act is that 'they' refers to principal of the bonds and 'income' refers to interest." See respondent's brief, p. 4, *Stern Bros.* v. *Commissioner*, *supra*. And that seems to be the essence of petitioner's present position.

[15] Act of July 14, 1870, c. 256, 16 Stat. 272, § 1, quoted along with other exemption statutes, Appendix, p. 7.

closer than it did, the Federal Reserve Act of 1913. That act, while exempting *income* derived from capital, reserve and surplus,[16] gave exemption to treasury notes only "as to principal and interest."[17] But this Congress did not do; it chose the same measure of exemption for bond and mortgage income that it did for capital and surplus income.

The same discrimination in language is discernible in other exemption statutes and throughout the years. For the liberty loan issues, coming very shortly after the Farm Loan Act, being direct obligations of the Government, only interest—sometimes only part of the interest—was exempted.[18] But for its various agencies Congress has apparently always felt that full exemption of all their income was advisable[19] even though at times it has exempted only interest on their debentures.[19a] In such statutes there are clearly expressed two measures of exemption. But for some agencies, not only has the income from their capital and surplus been made exempt, but also income from their bonds and debentures.[19b] Thus, after all the liberty loan acts, and with them and other statutes as precedents for narrower language, Congress nevertheless in 1923 extended to all intermediate credit banks, their capital, reserve and surplus, their bonds and mortgages, "and the income derived therefrom" the identical exemption contained in Section 26 of the Farm Loan Act.[19c] Again, in 1934, this was done in the Farm Mortgage Corporation Act,[19d] and yet again in 1938

---

[16] 38 Stat. 258; see Appendix, p. 11. See also discussion of this Act as the source from which the language of Sec. 26 came, *infra*, pp. 23-4.

[17] 38 Stat. 269; see Appendix, p. 8.

[18] See Appendix, pp. 8-10.

[19] See Appendix, p. 11.

[19a] See Appendix, pp. 12-16.

[19b] See Appendix, pp. 17-19.

[19c] 42 Stat. 1459. See Appendix, p. 17.

[19d] 48 Stat. 360. See Appendix, p. 18.

for the Commodity Credit Corporation and its debentures.[19e]

Had this occurred but once a reasonable doubt might be entertained as to its special significance. But recurring as it did repeatedly over a long period of years, in the face of ample precedent for choice of narrower language, and in the face of concurrent enactment of other exemption statutes using both broader and narrower language simultaneously, it has a legislative significance which cannot be ignored. It discloses a clear intention on the part of Congress to draw distinctions and to shape the respective exemptions to suit its differing policy to the different circumstances with which it was dealing. There can be no question that where the statutes refer to and exempt only interest, they have a narrower meaning than where they refer to and expressly exempt income. Unquestionably in the latter instances and in the absence of qualification, they include every kind of income, among which is capital gain as well as interest. As this Court has recently said in *Helvering* v. *Wood*, 309 U. S. 344, 347:

> "Whether as a matter of policy such nice distinctions should be perpetuated in a tax law . . . is not for us. We have only the responsibility of carrying out the Congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it."

E. There was sound reason for Congress to exempt capital gains from taxation. Faced with the farm crisis of 1912-13, the same Congress which under the Sixteenth Amendment passed the first income tax law of 1913, authorized the President to appoint a commission to study the field of rural credits.

The problem of the Commission (called the United States Commission) was to alleviat the crisis by providing long-term money to farmers at low rates of interest.

[19e] 52 Stat. 108; see Appendix, pp. 18-19.

Low rates to farmers could be insured if a supply of money at low rates to the banks could be guaranteed. The act provided (Secs. 12 and 16) that farmers could be charged on the money they borrowed only 1 per cent more than the land banks paid for money borrowed from investors. The ultimate problem, therefore, was that of making farm loan bonds attractive for investment purposes as against industrial issues and Government bonds.[20] To accomplish this, a plan had to be devised to insure a ready market—one that would be maintained both as to old and as to new issues as the best security against inadequate new funds and rising interest rates. If, for example, a bond already issued should drop appreciably below par, new bonds to be issued by the same bank would be compelled to pay a sufficiently larger rate of interest to make up the loss, and farmers who borrowed the new money would automatically have to pay a higher rate of interest.

Thus the supplemental statement of the Commission (H. R. Doc. 679, 63d Cong. 2d Sess., p. 16)[22] states:

> "Each bank is also authorized to deal in national land-banks bonds of other farm-land banks with its deposits. This will enable the bank with a large capital, located in a section where money is plentiful, to purchase and trade in the national land-bank bonds issued by banks in less favored sections, and thereby to main-

[20] H. R. Rep. No. 630, 64th Cong., 1st Sess., Parts 1 and 2, House Committee on Banking and Currency; Sen. Rep. No. 144, Senate Committee on Banking and Currency, 64th Cong. 1st Session. Report of U. S. Commission, Sen. Doc. No. 380, 63d Cong., 2d Sess.

[22] The Commission also states, *op. cit.*, p. 24:

> "This provision encourages the farmer to buy the national land-bank bonds of that bank when they fall below par, because thereby he can pay off his mortgage at less than its face. Such a provision will tend to maintain the market for the national land-bank bonds. Likewise the bank itself can buy its bonds in the market, cancel the same, and thereby release its proportionate part of the mortgages securing such issue. This likewise tends to encourage the bank to invest its surplus funds in its own national land-bank bonds, and tends to maintain the market."

> tain the market for its securities, and to use the funds available in one section of the country to meet the needs in other sections."

It should be sufficiently clear[23] that Congress considered a steady market and liquidity of the bonds a first essential to the success of the system.

Direct Federal aid and Federal guarantee of the bonds were considered but were recommended against.[24] The remaining alternative, and the one seized upon, in addition to prescribing certain safeguards against over-issuing bonds on the security available, was the granting of an extremely wide tax exemption. And it was not sufficient that this tax exemption should apply only to "interest", for investors could already purchase government bonds backed by the entire credit of the Government, on which interest was exempt. Rather, in order to give the bonds an advantage over other securities, it was considered necessary to make the exemption apply to all income connected with the new bonds. This was confirmed by Senator Hollis, in charge of the bill in the Senate (Cong. Record, Vol. 53, Part 8, p. 7312):

> "It would be futile—it would be useless—to pass this law unless we had given these investments a distinct advantage over other investments. They will have it; they ought to have it; and if this bill is passed, they will get it."

Hon. Ralph W. Moss, senior member of the House group on the joint sub-committee and who had been vice-chairman of the U. S. Commission, also so understood. Said he:

> ". . . the system rises and falls with this one paragraph of the bill [referring to what became Section 26]. . . . So the point I want to make clear is, that I am . . . making as strong an argument as I possibly can in favor

[23] See discussion of Farm Loan Act provisions, *supra*, pp. 16-17.

[24] Sen. Doc. 380, 63d Cong. 2d Sess., Parts I, II, p. 22; H. R. Doc. 679, 63d Cong., 2d Sess., p. 5; Cong. Rec. Vol. 53, Pt. 7, p. 6793.

of the exemption of the land mortgage and the land bond. And unless the committee sees fit to extend that exemption so far, you had just as well throw the bill in the wastebasket.

". . . there was no one feature of the bill to which so much thought was given as the question of exemption from taxation." (Hearings [joint] before Sub-Committee of Committees on Banking and Currency of the Senate and House of Representatives on Rural Credits, 63d Cong. 2d Sess., pp. 97-98).[26]

As against this theory of the legislature, petitioner (footnote, p. 11) asserts that whether the exemption from capital gains would make these bonds an attractive investment, is a "matter of mere speculation" because such exemption would "as a necessary concomitant, deprive investors of a deduction for losses on sales." The majority opinion in *Agriculture Securities Corp.* v. *Commissioner,* 39 B. T. A. 1103, makes the same argument.

The answer is two-fold: (1) Congress did not think the matter one of speculation, as evidenced by its action; (2) there is, so far as counsel have been able to discover, no statutory basis for the statement that an exemption as to capital gains would prevent a deduction as to capital losses. The statement in *Willcuts* v. *Bunn,* 282 U. S. 216, 231, relied on by petitioner, was itself a speculation by the Court as to the possible situation if Congress should so legislate and it does not seem to have any actual support in the statutes.

F. Examination of the legislative history of Section 26 further corroborates the intention to exempt capital gains on farm loan bonds. It must be borne in mind that the Sixteenth Amendment and the first income tax laws thereunder were new at this time, virtually contemporaneous with this farm loan legislation. Congress was not only decidedly income-tax-conscious, it was also conscious of the advantage it could give any new and favored project through exemp-

[26] See also testimony of Secretary of Treasury on the wider exemption enjoyed by these bonds than liberty bonds, *infra,* p. 29.

tion from the new tax. In 1913 it had done this very thing for the newly created Federal Reserve System, 12 U. S. C. § 531:

> "Federal Reserve banks, including the capital stock and surplus therein, *and the income derived therefrom* shall be exempt from Federal, State and local taxation except taxes upon real estate." (Dec. 23, 1913.) (Italics added)

This language was used for the avowed purpose of exempting the new banks from the newly enacted income tax law.[27] By reason of it Federal reserve banks have consistently been held exempt as to all their income, including capital gains; the exemption has even been held to extend to dividends on stock in the hands of member banks. Bulletin 1916 Federal Reserve Board, p. 153.

Three years later, for its new project to aid farmers, Congress lifted this language bodily from the Federal Reserve Act.[28] In doing so, Congress necessarily attached to it the same meaning that it had in the Federal Reserve Act itself.[29]

---

[27] See H. R. Rep. No. 69, Committee on Banking and Currency on Federal Reserve Banks, 63d Cong., 1st Sess. p. 39:

> "In view of the increasing burden of taxation *and of the Federal income-tax law which now furnishes an additional draft upon net earnings,* this exception is likely to prove of material importance * * *." (Italics added)

[28] See Report of the United States Commission, Sen. Doc. 380, 63d Cong. 2d Sess., Parts I and II, p. 33; Statement of Representative Moss in charge of bill in House, in Joint Hearings before Sub-Committees, Senate and House on Rural Credit, 63d Cong., 2d Sess., p. 97; Report of the United States Commission on National Farm Land Banks, H. R. Doc. 679, 63d Cong. 2d Sess., p. 18; the latter is a supplemental report of the U. S. Commission.

[29] *Hecht* v. *Malley,* 265 U. S. 144, 153 (citing cases); *Sessions* v. *Romadka,* 145 U. S. 29, 43. This is confirmed by the statement of Rep. Moss and Senator Hollis, in the course of the Joint Hearings before the Sub-Committee of the Committee on Banking & Currency, 63d Cong. 2d Sess., p. 95:

> "Mr. Moss: That provision in the bill was taken from the regional-bank [Federal reserve bank] provision, and the exact

The idea of complete exemption of both banks and bonds from taxation did not, of course, spring into being full-blown. (See Appendix pp. 24-26.) It was a natural growth which discloses how acutely conscious Congress was of the tax exemption feature. As originally written, the exemption of farm loan bonds specifically excluded income tax; it extended to "any tax, assessment, or charge (*other than income tax*) whether national, state or municipal." [30] (Italics added.) This was broadened after further study to exempt the national land banks bonds "from Federal, state and local taxation, except in respect to taxes upon real estate." [31] Senator Hollis, in charge of the legislation in the Senate, was in favor of exempting the banks from the income tax, whereas Representative Moss, in charge of the legislation in the House, was at first opposed, although ardently for the exemption of the bonds.[32] The matter was

---

language contained in that act was written here to extend the same favor to those [farm loan] banks which is shown to the regional [Federal reserve] banks, without creating any precedent.

"Senator Hollis: You see we did not need to encourage the incorporation of national banks, because we already have 7,500 of them; but here we are undertaking to go into a new field and encourage the establishment of banks that are sorely needed, and therefore I think we should have this exemption * * *" (Italics added.)

[30] Senate Committee Hearings, Committee on Banking and Currency, 1913-15, Vol. 35, p. 832.

[31] It was at this point that the words "income derived therefrom" were first used by the draftsman. The entire section, as it then stood, was as follows (Report of the United States Commission, Sen. Doc. 380, 63d Cong. 2d Sess., Parts I and II, p. 62):

"Section 18. That every national farm-land bank incorporated under the terms of this Act and the capital stock and surplus therein and the income derived therefrom and the mortgages and deeds of trust (and the notes and bonds secured thereby) held by said bank and the national land-bank bonds issued by the same shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate."

[32] Hearings before Joint Sub-Committee, Committees on Banking & Currency, on Rural Credits, 63rd Cong., 2nd Session, pp. 95-97.

compromised by the extension of the same exemption to banks and bonds. When the bills were introduced in the Senate[33] and the House[34] simultaneously thereafter, they contained a provision that "Farm loan bonds issued under the provisions of this act and the income derived therefrom shall be exempt from Federal, state and local taxation." The language finally enacted was adopted in the report of the Senate Committee on Banking and Currency.[35] Selection of the language finally adopted is further emphasized by the simultaneous rejection of two bills, one by Senator Norris[36] and one by Senator Gronna,[37] which were offered as substitutes for the committee bill, and each of which exempted only interest on bonds and mortgages.

There was general agreement in the debate that Congress was adopting the broadest possible exemption in order to promote its policy with respect to the legislation.[38] These expressions came alike from those who favored the exemption and those who opposed it; and the unanimity with which the breadth of the tax exemption provision was viewed is persuasive. *Federal Trade Commission* v. *Rala-*

---

[33] S. 289, 64th Cong. 1st Sess., Sec. 29.

[34] H. R. 15004, 64th Cong. 1st Session, Sec. 23; H. R. 630, 64th Cong. 1st Session.

[35] S. Report 144, 64th Cong. 1st Session, p. 32 on S. 2986.

[36] S. 4061, 63 Cong., 2d Sess.

[37] Printed in 53 Cong. Rec. Part 8, pp. 7385-8; see § 24, p. 7387.

[38] In addition to the expressions of Mr. Moss quoted above and Senator Hollis, see that of Senator Lodge of Massachusetts as to total tax exemption, 53 Cong. Rec. p. 7128; Senator Cummins of Iowa, *Id.* p. 7311; Governor Herrick of Ohio in letters to Senator Harding introduced into the Record, *Id.* p. 6850; Senator Hollis, *Id.* p. 6851, 6696-7; Representative Moss in hearings before the joint sub-committee of the Committee on Banking and Currency, 63d Cong., 2d Sess., p. 95-7. Compare statement of C. C. Atcheson, one of the agricultural experts for the period of the hearing and who protested the exemption of income tax upon profits of individuals, Joint Hearing, *supra*, p. 263-264. These are collected in the Appendix, pp. 26-29.

dam Co., 283 U. S. 643, 649-651; *Humphrey's Executor* v. *United States*, 295 U. S. 602, 625.

The consistent course of Congress in this connection is recognized in the Act of May 12, 1933, c. 25, § 29, 48 Stat. 46, 12 U. S. C. § 810, which provided for the liquidation of joint stock land banks, and Sec. 817 of the Revenue Act of 1938 dealt with at length below pp. 34-39. These banks had, according to the Congressional view, served their purpose, and by the act first named had been forbidden to make any loans to farmers or to issue new bonds except in liquidation of pre-existing loans or bonds. There was, therefore, no need, so far as these banks were concerned, longer to encourage the maintenance of high market prices for their bonds. Consequently Congress by Section 817 of the Revenue Act of 1938 reversed its prior policy and provided with respect to all bonds to be thereafter issued by joint stock land banks (but not those to be issued by Federal land banks) that "all income, except interest" should be taxable.[39]. The exemption as to bonds issued by Federal loan banks was of continued necessity by reason of the added responsibility on the Federal land banks to loan money to farmers at low rates. Congress also continued the total exemption with respect to bonds of intermediate credit banks (42 Stat. 1459) and to mortgages and bonds of the Federal Farm Mortgage Corporation (48 Stat. 360) although it had been proposed to the Finance Committee that the total exemption be withdrawn as to the bonds of all these agricultural corporations (Hearings before the Committee on Finance, U. S. Senate, 75th Cong., 3d Sess. on H. R. 9682, Part 4, pp. 614-619). And finally, the very Congress which in 1938 amended Section 26 as to

---

[39] The Farm Loan Act of 1916 set up two different kinds of land banks (1) the Federal land banks patterned in some respects after the Federal Reserve System, with the United States as direct owner of stock which was unsubscribed when the system was inaugurated (Farm Loan Act, Sections 4 to 15); (2) the Joint Stock Land Banks owned strictly by private enterprise (Farm Loan Act, Section 16 *et seq.*).

joint stock and land bank bonds, granted an exemption to the Commodity Credit Corporation couched in the identical language of the original Section 26.[40] Intermediate credit banks, the Commodity Credit Corporation, and the Federal Farm Mortgage Corporation, like the Federal land banks, are current institutions with contemplated future activity, as contrasted with joint-stock land banks, which had become moribund.

G. The fact that the words "income derived therefrom" include capital gains has been consistently (with the exception of the ruling in the present case) observed by the administrative branch of the Government. That phrase as used in the Federal Reserve Act of 1913, and as used in the first sentence of Section 26 since 1916 has been interpreted to exempt Federal reserve and Federal land banks from paying a tax on any income. These banks do not even file income tax returns. We are also informed by the other agencies to which the same exemption has been accorded (Federal Reserve banks, Federal Intermediate Credit bank, Federal Farm Mortgage Corporation and the Commodity Credit Corporation) that they do not pay taxes upon any of their income including capital gains, or even file income tax returns.[41]

The construction of the phrase "income derived therefrom" contained in the second sentence of Section 26 has been to the same effect. Thus, under the "duty" placed upon the Farm Loan Bureau by Section 3 of the Farm Loan Act "to prepare and distribute . . . circulars . . . advising investors of the merits and advantages of Farm Loan Bonds," (12 U. S. C. § 664 that Bureau from the beginning distributed circulars in which it was represented to the public that the bonds and their income were "free from all forms of taxation" including "income tax and all

---

[40] Act of March 8, 1938, c. 44, 52 Stat. 107, 108, § 5.

[41] The exemption contained in this first sentence of Section 26 has been construed by the Treasury Department to extend even to interest on promissory notes executed by Federal land banks when they borrow money. (Cf. IT. 1806, C. B. II-2, 92, 1923.) For exemption statutes covering the above named agencies, see Appendix hereto, pp. 17-19.

forms of State and municipal tax of every kind and character," etc. (R. 42)

As early as two years after the passage of the Farm Loan Act, the Secretary of the Treasury answered the question here involved. During the course of a Congressional hearing on the Revenue Act of 1918, in response to a question as to why the Treasury was not then selling farm loan bonds he replied:

> "(Secretary McAdoo): The only reason they have not been sold this year was because I did not want to set up competition between the land banks and the Treasury Department in the sale of securities. Land bank bonds carry a wider exemption than liberty bonds." (Senate Hearings, H. R. 12863, part 2, page 117, 65th Cong., 2d Sess).

Since at that time some of the Liberty Loan Bonds outstanding exempted principal and all interest from taxation, the Secretary must have understood that farm loan bonds also exempted capital gains—the only other kind of income possible.

This understanding was reiterated by the General Counsel of the Bureau of Internal Revenue on May 2, 1933. On that date, in response to an inquiry from the Des Moines Joint Stock Land Bank he ruled that capital gains made by that taxpayer on dealings in its own bonds were exempt (Ex. 6, R. 85), see supra, p. 17. This ruling was duly circularized to all banks (Ex. 7, R. 94). It has never been overruled, but on the contrary has been recognized to cover also gains made by banks on bonds of other banks (R. pp. 95-6). Through such dealings, joint stock land banks have netted profits in excess of a hundred million dollars (R. pp. 100-1), all of which has been held exempt (R. p. 101) and statutory closing agreements with at least seven banks so profiting, under which it was agreed that no taxes were due, were entered into under the provisions of Section 606, Revenue Act of 1928, said agreements being dated as late as July 23, 1936, and June 8, 1937 (Ex. 8, R. 99-100). The

attempt of the taxing authorities to tax the present taxpayer, after having exempted from taxation profits of the same kind made by joint stock land banks, aggregating over one hundred million dollars, is, we submit, discrimination of a kind that this Court should not permit.

Furthermore, when, pursuant to Act of May 12, 1933, (C. 25. §29, 48 Stat. 46) joint stock land banks were required to liquidate and were selling their mortgages to the public, another ruling was handed down by the General Counsel of the Bureau of Internal Revenue that the exemption of income derived from mortgages issued to joint stock land banks, and by them sold to individuals, continued in favor of the purchasers (Ex. 9, R. 103). Mortgage income is exempted by the same sentence which exempts bond income.

The author of the majority opinion in *Agriculture Securities Corp.* v. *Commissioner* (1939), 39 B. T. A. 1103, 1111-1112, dismissed the matter of administrative construction on the ground that it was neither uniform nor of long standing. Apparently it was not regarded by the Member as uniform because in the present case a cavalier memorandum had been written, in which (Ex. 10, R. 106), while the earlier opinion was not repudiated, it was sought to be distinguished as dealing with the incomes of banks and not those of individuals.[42] If, in a given case, any tax collector, in the face of long continued and well settled administrative construction, could prevent that construction from being "uniform" by merely making a contrary determination, then no taxpayer could ever rely on administrative construction no matter how cogent its reasoning, however many times re-affirmed, or how long continued it may have been. This Court is aware that the doctrine itself is of effect even though the taxing authorities in a particular case assert a view contrary to that previously uniformly held. The Board member overlooked all of the instances of

---

[42] See footnote 13, p. 17.

administrative interpretation which we have discussed above except the *Des Moines* opinion, its circulation, and the memorandum issued in this case.

Petitioner would dismiss (Petr.'s Brf. p. 19) as unpublished memoranda not binding on the Department the General Counsel's decision of April 3, 1933 (R. 85-93) and the letter of the Farm Credit Administration of Sept. 12, 1934 (R. 103, 104). But as the record shows, both of these memoranda were duly circularized by the Treasury Department (Farm Loan Bureau) and by the Farm Credit Administration (see Ex. 7, R. 94; Ex. 9, R. 103). They are important not only because they are official determinations of the Government officers charged with the enforcement of the law and by them duly publicized, but because, as the court below said, their "reasoning continues sound", (R. 131) and they are in accord with the well-settled construction above outlined.

It is, of course, elementary that administrative construction such as here exists is entitled to great weight and will not be disturbed except for cogent reasons. *Brewster* v. *Gage*, 280 U. S. 327; *Willcuts* v. *Bunn, supra.* Particularly is this so where, as here, the construction is against the tax asserted and in favor of the person affected. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110; *Lincoln Chemical Co.* v. *Edwards*, 289 Fed. 458, 462; *Edwards* v. *Wabash Ry. Co.*, 264 Fed. 610; *Bowers* v. *West Virginia Pulp & Paper Co.*, 297 Fed. 225, cert. den., 265 U. S. 584.

Moreover, Congress has accepted and ratified the administrative interpretation. This acceptance and ratification consists partly in refusal until 1938 to amend Section 26 in the face of the existing administrative construction, and despite constant amendment of the rest of the act; partly in its extension of the exemption to include other instrumentalities; and finally, of its express recognition of the general counsel's opinion in the *Des Moines* case (R. 85-93 Ex. 6) as correctly stating the law.

From 1916 to 1938 the Farm Loan Act was amended on at least 20 different occasions.[43] And yet although as early as 1918 the Secretary of the Treasury had indicated the breadth of the exemption, Section 26 was not amended in any particular. On the contrary, on at least one occasion, notwithstanding the favorable Committee report, Congress refused to interfere with the exemption. See S. 319 and Report 317, 66th Cong., 1st Sess. of Committee on Banking and Currency. Within less than a year after the publicizing of the Des Moines Opinion, Congress gave comprehensive consideration to the Farm Loan Act, amending it on three different occasions in important respects.[42b] But again no attempt was made to cut down on the scope of the tax exemption. On the contrary, the scope of Section 26 has been extended to other agencies and instrumentalities. See *supra*, pp. 19-20, 27-28.

This long acquiescence has itself amounted to legislative approval. *Helvering* v. *Winmill*, 305 U. S. 79, 83; *U. S.* v.

---

[43] Act of January 18, 1918, c. 9, 40 Stat. 431; Act of April 20, 1920, c. 154, 41 Stat. 570; Act of May 29, 1920, c. 215, 41 Stat. 691; Act of February 27, 1921, c. 78, 41 Stat. 1148; Act of March 4, 1921, c. 151, 41 Stat. 1362; Act of July 1, 1921, c. 39, 42 Stat. 105; Act of August 13, 1921, c. 63, 42 Stat. 159; Act of March 4, 1923, c. 252, 42 Stat. 1454, Titles I, II, III; Act of March 4, 1925, c. 524, 43 Stat. 1262; Act of March 4, 1929, c. 700, 45 Stat. 1558; Act of June 26, 1930, c. 613, 46 Stat. 815; Act of March 4, 1931, c. 518, 46 Stat. 1548; Act of January 23, 1932, c. 9, 47 Stat. 12; Act of May 19, 1932, c. 191, 47 Stat. 159; Act of March 4, 1933, c. 270, 47 Stat. 1547; Act of June 16, 1933, c. 98, Title VII, 48 Stat. 257, 269; Act of June 3, 1935, c. 164, 49 Stat. 313; Act of June 24, 1936, c. 762, 49 Stat. 1912; Act of July 22, 1937, c. 516, 50 Stat. 521; Act of August 19, 1937, c. 704, 50 Stat. 703.

See also Act of May 15, 1922, c. 190, 42 Stat. 541, 542, § 3; Act of March 10, 1924, c. 46, 43 Stat. 17, § 2; Act of May 24, 1926, c. 377, 44 Stat. Part II, 628; Act of February 2, 1932, c. 14, 47 Stat. 36.

[42b] Act of May 12, 1933, Title 2, Parts 1, 2 and 3, 48 Stat. 41, 46, 48, 51; Act of June 16, 1933, Title 7 and 8, 48 State. 269, 273; Act of June 30, 1934, 48 Stat. 542.

Dakota Montana Oil Company, 288 U. S. 459, 466; *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S. 289, 293, 294; *National Lead Co.* v. *United States*, 252 U. S. 140, 146.

In *Manhattan Properties* v. *Irving Trust*, 291 U. S. 320, this Court held that the action of Congress in refraining over a period of 34 years from amending a certain portion of the Bankruptcy Act during which time Congress had passed other amendments to the act was persuasive that the construction adopted had been acceptable to the legislative arm of the Government and was tantamount to a legislative interpretation. And see *Sessions* v. *Romadka*, 145 U. S. 29, 41, 42; *Electric Storage Battery Co.* v. *Shimadzu*, 307 U. S. 5, 14, and cases cited therein, note 18.

Moreover, Congress by enacting Section 817 of the Revenue Act of 1938, with the Des Moines opinion, spead upon the minutes of its Finance Committee,[43] affirmatively approved of the interpretation already given.[43a] By that statute Congress provided that as to all bonds issued after that date "*all income, except interest, derived therefrom* shall be included in gross income and shall not be exempt from Federal Income taxation." The Committee in reporting this legislation said that it did not apply retroactively "for constitutional reasons". No matter if theretofore the statute had been doubtful or not, no matter if the representations to the public and the rulings of the department had been positively erroneous, no matter if they covered a long or a short period of time or were not uniform, the issue was definitely and positively decided in favor of the taxpayer by this new enactment. In *Silas Mason Co.* v. *Tax Commissioner*, 302 U. S. 186, 208, this Court held:

> "The federal intent in this instance is clearly shown. It is shown not merely by the action of administrative

[43] Hearings, Senate Committee on Finance, 75th Cong., 3d Sess. on H. R. 9682, Part 4, pp. 64-103.

[43a] See pp. .... to .... hereof.

officials, but by the deliberate and ratifying action of Congress, *which gives the force of law to the prior official action even if unauthorized when taken.*"[44] (Italics added.)

H. That Section 26 exempts capital gains was affirmatively recognized by the legislative branch of the Government in Section 817 of the Revenue Act of 1938 which provides (Revenue Act 1938, C. 289, 52 Stat. 578, 12 U. S. C. Section 931-a, 26 U. S. C. Sec. 3799):

"Notwithstanding the provisions of Section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this

---

[44] In *Swayne & Hoyt* v. *U. S.*, 300 U. S. 297, 301, this Court held that:

"It is well settled that Congress may, by enactment not otherwise inappropriate, 'ratify . . . acts which it might have authorized.'"

Even where there is no direct ratification, if such is the fair implication of the Congressional action it is sufficient.

Hamilton v. *Dillin*, 21 Wall. 73; *Mattingly* v. *District of Columbia*, 97 U. S. 687; *Wilson* v. *Shaw*, 204 U. S. 24; *Charlotte Harbor & N. R. Co.* v. *Welles*, 260 U. S. 8. Even if such ratification comes after an action has been filed based on previous invalidity of the administrative act, it is sufficient, *United States* v. *Heinszen & Co.*, 206 U. S. 370; *Tiaco* v. *Forbes*, 228 U. S. 549; *Rafferty* v. *Smith, Bell & Co.*, 257 U. S. 226 for "What the legislature could have authorized, it can ratify if it can authorize at the time of ratification." *Charlotte Harbor & N. R. Co.* v. *Welles*, *supra*. And this is true even if the action of Congress in 1938 were based on an erroneous belief as to what the law was. In *Helvering* v. *Gowran*, 302 U. S. 238, 242, this Court so held:

"The purpose of Congress when enacting Section 115(f) • • • may have been adopted in the erroneous belief that under the rule declared in that case [*Eisner* v. *Macomber*, *supra*] no stock dividend could be taxed. But such facts would not justify the Court in departing from the unmistakable command embodied in the statute."

Act, *all income, except interest*, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation." (Italics added)

The history of this amendment is as follows:

The hearings before the Senate Committee on Finance (Hearings, Sen. Com. on Finance, 75th Cong., 3rd Sess., on H. R. 9682, Part 4, pp. 614-15) disclose that it had before it for consideration in its search for new revenue sources the suggestion that the exemption theretofore given by three statutes to capital gains on various bonds and mortgages be removed, limiting them to the same exemption conferred on government bonds. The three statutes referred to were the Farm Loan Act here involved, the Intermediate Credit Bank Act of 1923, and the Farm Mortgage Corporation Act of 1934. (See Appendix, pp. 17-19)[44a]

After consideration, however, the committee recommended to the Senate the elimination of capital gain exemption on joint-stock land bank bonds only, leaving the exemption on the others unchanged. The proposed amendment read:

816. "Notwithstanding the provisions of Section 26 of the Federal Farm Loan Act, as amended, gain realized on the acquisition by a joint stock land bank of obligations issued by it or mortgages made by it, if such

---

[44a] An amendment to the Revenue Act to accomplish this was proposed as follows, op. cit.:

"All income, except interest, derived from mortgages or farm-loan bonds, issued hereafter pursuant to the provisions of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380), as amended, the Federal Intermediate Bank Act of March 4, 1923 (42 Stat. 1459), as amended, and the Federal Farm Mortgage Corporation Act of January 31, 1934 (48 Stat. 344), as amended, shall be included in gross income; and all acts pertaining to said mortgages and bonds are hereby amended accordingly."

> obligations or mortgages are made or issued after the date of the enactment of this act, shall not be exempt from federal income taxation."

In its report on the bill, the committee stated that "gain realized on such purchase [and sale at a profit] is, under law taxable income and in the case of an ordinary corporation is taxed. Under the Federal Farm Loan Act which governs the taxability of obligations of joint stock land banks, such income is exempt."[45]

As to this affirmative statement of understanding, petitioner quibbles, by saying (Petr.'s Brf. p. 17) that:

> ". . . insofar as it [Sec. 26] affects the taxation of capital gains of other than joint stock land banks themselves, its purpose was clarification, rather than change."

But petitioner overlooks the legislative history of this section. The committee report above quoted explicitly states that "*such income is exempt,*" not that only such income to joint-stock land banks was exempt. And during the reading of the Revenue Act in the Senate, paragraph by para-

---

[45] The entire statement of the Committee on this is as follows:

> "It has been brought to the attention of the Committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint stock land banks *such income is exempt.* The Committee is of the opinion that such income ought to be taxed. A similar situation exists with respect to mortgages issued by such banks and acquired at less than cost. *For constitutional reasons the provision is confined to gains realized upon bonds and mortgages issued after and acquired after the date of the enactment of the bill.*" (Italics added.)

graph, the ranking Democratic member (Mr. King) of the Committee on Finance made this statement:

> "Mr. President, with respect to the amendment just agreed to, Section 816, my attention has been called to the fact that perhaps the language is not as broad as it should be, and it is now being considered by the Treasury officials. Before we conclude the consideration of the bill I shall offer an amendment to broaden and amplify the provision."[46] (Cong. Rec. Vol. 83, 75th Cong. 3d Session, p. 6504). (Italics added)

Two days later the same Senator offered an amendment to Section 816 which was agreed to and became Section 817 of the enacted law. It was officially explained as follows (Cong. Rec. Vol. 83, 75th Cong. 3d Session, p. 6765):

> "The bill as reported [Section 816] subjected to Federal income taxation capital gains realized by a joint-stock land bank on obligations issued and mortgages made by it after the date of the enactment of the act. *The effect of the amendment* [to Sec. 816, and passed as Sec. 817] *is not only to tax that gain but also to tax gain realized by another joint-stock land bank or by an individual or corporation which itself is not exempt from Federal taxation. Thus, gain on a sale of such a joint-stock land bank bond by an investor is subject to tax.* The amendment continues the present provision of law under which interest on such bonds and mortgages is exempt from Federal taxation." (Italics added)

This discloses a purpose to amend Section 26 and limit the exemption granted therein to obligations issued by joint stock land banks after May 28, 1938. Conversely it dis-

---

[46] *Cf. Hassett* v. *Welch*, 303 U. S. 303, 310:

> "Bearing in mind that the resolution was prepared and its passage recommended by the Treasury, the administrative interpretation supports in uncommon measure the view that it was not intended to operate upon transfers completed prior to its passage."

closes the purpose and intention that Section 26 and the exemption therein granted should continue as to obligations issued before May 28, 1938.

Thus, Congress declares as to joint stock land bank bonds issued after May 28, 1938, that "All income, except interest, derived therefrom, *shall be included* in gross income and *shall not be exempt* from Federal income taxation." (Italics ours) and conversely paraphrasing the language of Section 817, it declares as to all such bonds issued prior to May 28, 1938, that "all income derived therefrom *shall not be included* in gross income, and *shall be exempt* from Federal income taxation." (Italics ours)

If, as the Government contends, capital gains were taxable under the language of Section 26, why the necessity of this amendment? Or if, as the Government contends, Section 26 was construed by the succeeding Revenue Acts to exempt only interest, why the necessity of this amendment? As stated by Mr. Justice Sutherland in *Mid Northern Oil Co.* v. *Walker*, 268 U. S. 45, 48:

> "It fairly cannot be supposed that Congress would indulge in the altogether idle ceremony of enacting a law to save rights which, being in no way challenged or affected, stood in no need of being saved."

The legislative interpretation is entitled to great weight. *United States* v. *Freeman*, 3 How. 556, 564-565, states the rule as follows:

> "if it can be gathered from a subsequent statute *in pari materia*, what meaning the legislature attached to the words of a former statute, they will amount to a legislative declaration of its meaning, and will govern the construction of the first statute. [Citing cases] . . . This court has repeatedly, in effect, acted upon the rule, and there may be found, in the reports of its decisions, cases under it, like the cases which have been cited from the reports of the English courts. In 4 Dall., 14, 'The intention of the Legislature, when discovered,

must prevail, any rule of construction declared by previous acts to the contrary notwithstanding.' "[47]

Petitioner attempts to combat this legislative interpretation by cases cited for the proposition that imposition of a tax by a later act is not a Congressional declaration that the subject was not taxed theretofore. The cases cited involved situations where the history of the particular later acts showed affirmatively that the new act was not the declaration of a new policy (*Jordan* v. *Roche*, 228 U. S. 436, 441; *Hartley* v. *Commissioner*, 295 U. S. 216, 220-221), or was affirmatively shown to have been intended to be merely declaratory of existing law as administered (*Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312, 322), or where the new provision went further than the former decisions, so that it was intended to extend as well as clarify the existing law (*Higgins* v. *Smith*, 308 U. S. 473, 479-480), or where the legislative purpose was shown not to have changed when variations of language occurred in the later act, so that the new words were a mere clarification of existing law (*Helvering* v. *New York Trust Co.*, 292 U. S. 455, 468-469).

Such cases have no application here. The language of the committee quoted above—to say nothing of the balance of the legislative history of §817—admits of no doubt as to how the legislators who adopted §817 regarded the meaning of the words "income derived therefrom" in §26 of the Farm Loan Act. Section 817 is clearly *in pari materia* with §26 of the Farm Loan Act, and as such is properly to

---

[47] To the same effect are *Alexander* v. *Mayor, etc.*, 5 Cranch. 1, 7-8; *Matthews* v. *McStea*, 91 U. S. 7, 12-13; *New York, P. & N. R. Co.* v. *Pennsylvania Exchange*, 240 U. S. 34, 39; *Cope* v. *Cope*, 137 U. S. 682, 688; *Tiger* v. *Western Investment Co.*, 221 U. S. 286, 309; *First Natl. Bank* v. *Missouri*, 263 U. S. 640, 658-9; *Swigart* v. *Baker*, 229 U. S. 187, 197; *Sarlls* v. *United States*, 152 U. S. 570, 576-7; *Pompton* v. *Cooper Union*, 101 U. S. 196, 201-202; *Farmers', etc. National Bank* v. *Dearing*, 91 U. S. 29, 36; *License Tax Cases*, 5 Wall. 462, 473; *Spencer* v. *United States* (8 C. C. A. 1909) 169 Fed. 562, 564; *Barber Asphalt* v. *Denver* (8 C. C. A. 1896) 72 Fed. 336, 345.

be employed as an aid to statutory construction. See cases *infra*, and Petr.'s Brf. p. 11, note 7.

I. The Farm Loan Act, containing Section 26, became law on July 17, 1916. On Sept. 8, 1916, less than two months later, Congress passed the Revenue Act of 1916 which by Section 4 enumerated various bonds on which interest was exempt, one of which was "securities issued under the provisions of the Federal Farm Loan Act." Revenue acts since that time have contained a similar provision.[47a]

In the court below, and in other similar cases, petitioner contended that even if Section 26 originally exempted capital gains, the exemption as to income other than interest was impliedly repealed by these provisions of the Revenue Act. In this Court petitioner apparently abandons that contention. (*Cf.* Petr.'s Brf. p. 5, 10-11).[48]

[47a] See App., pp. 4-6.

[48] The point is properly abandoned since it was without foundation. The revenue acts, commencing with the Revenue Act of 1916, c. 463, 39 Stat. 756, have provided (§22, 39 Stat. at p. 776) that special provisions of law not specifically repealed and not inconsistent are extended and made applicable to the taxing statute—thus evincing an intent not to repeal. Repeals by implication are not favored. *Morris* v. *Arthur*, 95 U. S. 144, 146; *Rodgers* v. *United States*, 185 U. S. 83, 87-89; *State* v. *Stoll*, 17 Wall. 425, 436; *Ex parte Crow Dog*, 109 U. S. 556, 570; *United States* v. *Nix*, 189 U. S. 199, 205. And an intent to repeal must be found, as in an irreconcilable conflict or by virtue of the later statute's covering the entire ground of the earlier one. *Red Rock* v. *Henry*, 106 U. S. 596, 601-602; *Posadas* v. *National City Bank*, 296 U. S. 497, 503 *et seq.*; *Graham* v. *Goodcell*, 282 U. S. 409, 425-426; *Washington* v. *Miller*, 235 U. S. 422, 428; *Frost* v. *Wenie*, 157 U. S. 46, 58; *Morf* v. *Bingaman*, 298 U. S. 407, 414. Where both acts are affirmative (*United States* v. *Gillis*, 95 U. S. 407, 416), the earlier, special act is read as an exception to the later, general revenue act. See *Rodgers* v. *United States; Washington* v. *Miller*, both *supra*. The Revenue Act, in merely summarizing the exemptions of interest from tax, obviously did not cover the whole field of Section 26, let alone the entire field covered by the Farm Loan Act. In the Revenue Act of 1916, Congress did not undertake to undo what it had just done a few weeks earlier in the Farm Labor Act. *Cf. Graham* v. *Goodcell; Morf* v. *Bingaman*, both *supra*. Since the exemptions contained in

Instead, petitioner now asserts that the revenue acts constitute a legislative interpretation of Section 26 to the effect that Congress thought it had exempted only interest. This contention is also unsound. There is nothing in the legislative history of Section 4 of the Revenue Act of 1916 or succeeding statutes to show that it was intended as an interpretation of Section 26. Neither does the language of the Revenue Act indicate any such intention. To paraphrase the statement of Mr. Justice Holmes in *United States* v. *Stafoff*, 260 U. S. 477, 480 "This section [§4] is not declaratory even in form. It does not purport to construe" Section 26. It is apparent from the structure of the various revenue acts that all Congress intended to do by Section 4 was to summarize in one convenient place exemptions pertaining to interest on government instrumentalities, and

---

both acts are not inconsistent, they can and should both function together.

A consistent line of administrative and judicial interpretation demonstrates that the revenue acts are not the sole source of exemptions, and do not repeal earlier special statutes granting specific exemptions. See Regulations 45, Art. 71; Regulations 74, Art. 81, and, generally, see Regulations 74 and 77, Arts. 85 to 90, inclusive, for references to specific acts as sources of exemptions, rather than to provisions of revenue acts; as to Federal Reserve Banks, see Regulations 62 and 45, Art. 76; Regulations 74, Art. 86; Regulations 77, Art. 86; as to annuities stated generally by the Revenue Act to be included in gross income but excepted by virtue of an earlier statute saying they should not be subject to any tax, see Office Decision (I. T.) 3069, CB 1937-1, p. 59; as to veterans' compensation, see I. T. 2655, XI-2 CB p. 19; I. T. 2779, XIII-1 CB p. 37; as to exemptions of Indians and Indian tribes despite tax statutes imposing a tax on "every individual", see 35 Opp. Atty. Gen. 107 (and opinion cited therein); 34 Opp. Atty. Gen. 275, Treas. Decision 3570, III-1, CB p. 85; 34 Opp. Atty. Gen. 439, Treas. Decision 3754, IV-2 CB p. 37; *Blackbird* v. *Commissioner Int. Rev.* (C. C. A. 10th, 1930), 38 F. 2d 976; *Homeratha* v. *United States* (W. D. Okla., 1930), 40 F. 2d 305, app. dis. (C. C. A. 10th, 1931), 49 F. 2d 1086; *Dick* v. *Commissioner* (C. C. A. 10th, 1935), 76 F. 2d 265, Cert. den. 296 U. S. 588; *Pitman* v. *Commissioner* (C. C. A. 10th, 1933), 64 F. 2d. 740.

Other matters which go as well to repeal by implication as to legislative interpretation, now asserted, are dealt with in the text.

that it was not intended to cover all exemptions secured by the Farm Loan and other special exemption acts. The revenue acts are not, as contended by petitioner, *in pari materia* with the Farm Loan Act; the Farm Loan Act is a special act dealing comprehensively with all the relations of the farm loan system to the Government. Section 26 is concerned with all phases of tax exemption in that system. The revenue acts relate to the raising of revenue in general, and make no attempt to encompass special exceptions or exemptions contained in special acts. (See note, p. 48, *supra.*)

The history of the administration of the Farm Loan Act demonstrates that the Treasury Department has always regarded Section 26 alone as the controlling statute. No mention, so far as we have been able to find, has ever been made of the revenue acts as interpreting Section 26 or having anything to do with its exemption. Circulars prepared by the agency charged with the administration of the Farm Loan Act (as authorized and required by Section 3 of the Act) have always referred to Section 26 as the sole applicable exemption statute. Moreover, when in 1923, after eight years of such representation to the public, Congress extended the provisions of Section 26 to Intermediate Credit Banks, it did so in language that gave not the slightest intimation that the section had been in any way interpreted or limited by any other statute whatsoever. Again in 1934, when the Federal Farm Mortgage Corporation was established, there was no intimation that the language of exemption in that statute, which was identical with Section 26, had been in any way limited or interpreted; and again this was true in 1938, when the same language of exemption was used in the Commodity Credit Corporation Act. See these three acts and Appendix, p. .

It is required by Section 21 of the Act that among other things the bonds shall show on their face that they are "not taxable by national, state, municipal or local authority." Pursuant thereto and from the very beginning the bonds

(R. 33) have consistently quoted the language of Section 26 as being the sole measure of exemption, reading:

> "This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that 'farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they *and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation.'" (Italics added.)

If, as petitioner now claims, Section 26 was restricted to "interest" the Revenue Act of 1916, the bonds should have so stated. A determination now that the Revenue Act rather than the Farm Loan Act was the applicable statute would place the government in the embarrasing position of having approved and delivered over a period of twenty years bonds containing a misrepresentation as to the applicable statute.

In our view there was no such misrepresentation. The Government was very careful to publicize the proper exemption statute. For following the amendment of Section 26 by the Revenue Act of 1938, Section 817, joint stock land bank bonds were changed to read as follows:

> "This bond is issued under auhority of the Federal Farm Loan Act, approved July 17, 1916, and amendments thereto. Section 26 of the Federal Farm Loan Act, as amended, provides that 'Farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such, they and the income derived therefrom, shall be exempt from Federal, state, municipal and local taxation. Section 817 of the Revenue Act of 1938, effective May 27, 1938, provides that, notwithstanding the provisions of Section 26 of the Federal Farm Loan Act as amended, in the case of . . . obligations issued by any joint stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross

income and shall not be exempt from Federal income taxation.' "[50]

III. Neither the Rule of Strict Construction Nor the Argument Based on the Exemption from State Taxation Can Prevail.

A. The doctrine of strict construction cannot defeat the exemptions contained in the Farm Loan Act. It is really a part of the larger doctrine[51] that acts levying taxes will not be extended by implication beyond the clear import of the language used. That is, a tax act will be construed strictly to exclude subjects from taxation which are not clearly within the language used, and strictly to limit exemptions from the tax where the subject of the tax is clearly within the act. None of the cases cited by petitioner, Brief p. 21, go beyond this point, and none of them justify restricting the plain meaning of the words used in Section 26. Here the Government, in asserting the tax, takes the position that gains and profits are one kind of income within the meaning of the income tax act; but if so, so also is that particular type of gain or profit derived from bonds issued by joint stock land banks, and as such exempt. Construing the word "income" strictly does not keep gains and profits from amounting to "income"; nor by construing strictly the phrase "income derived therefrom" can the source of that income be changed. Just so, construing these words strictly cannot keep the gains and profits here involved from the exemption granted by Congress. As stated by this

---

[50] The first issue of bonds under the amendment was subsequent to the date of the trial of this case. However, the court may take judicial notice of the provision of the bonds. *Grosfield* v. *First National Bank*, 73 Mont. 219, 231, 236 Pac. 250, 254; *McNeil* v. *McNeil*, 61 Utah 141, 144, 211 Pac. 988; *cf. Caha* v. *United States*, 152 U. S. 211, 221.

[51] *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 93; *Gould* v. *Gould*, 245 U. S. 151, 153; and see the collection of many cases in 1 Paul and Mertens, Law of Federal Income Taxation, Section 3.31, pp. 62-66.

Court in *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 94:

> "The rule of strict construction is not violated by permitting the words of a statute to have their full meaning, or the more extended of two meanings. The words are not to be bent one way or the other, but to be taken in the sense which will best manifest the legislative intent."

And in *Pittman* v. *Home Owners Loan Corporation*, 308 U. S. 21, 31, the Court said:

> "The critical term in the present relation is 'loans.' We think that this term, in order to carry out the manifest purpose of the broad exemption, should be construed as covering the entire process of lending, the debts which result therefrom and the mortgages given to the corporation as security."

The doctrine of strict construction is only an aid to construction. *Citizens' Bank* v. *Parker*, 192 U. S. 73, 86; *United States* v. *Freeman*, 3 How. 556, 565; *Kohlsaat* v. *Murphy*, 96 U. S. 153, 160. The Court cannot examine one canon to the exclusion of all others; nor is a doubt to be decisive against an exemption until all effort to determine the true intent has failed, for it is the function and duty of the court to resolve doubts. *White* v. *United States*, 305 U. S. 281, 292. The goal is the determination of the intent of Congress, and all aids to finding that intent are to be seized.[52] We believe that a reading of Section 26, either by

---

[52] "We recognize the force and salutary character of the rule, but it must not be misunderstood. It is not a substitute for all other rules. It does not mean that whenever a controversy is or can be raised of the meaning of a statute, ambiguity occurs, which immediately and inevitably determines the interpretation of the statute. The decisive simplicity of such effect is very striking. It conveniently removes all difficulties from judgment in many cases of controverted construction of laws. But we cannot concede such effect to the rule, nor is such effect necessary in order to make the rule useful and, at times, decisive. Its proper office is to help solve ambiguities, not to compel an immediate surrender to them—to be

itself or in its setting in the act as a whole, makes the meaning of Congress evident that gains and profits shall be exempt. If that is so, the doctrine of strict construction is wholly inapplicable: the statute must be applied according to its plain meaning. *Pittman* v. *H. O. L. C.*, 308 U. S. 21, 31; *Kohlsaat* v. *Murphy*, 96 U. S. 153, 160; *Citizens' Bank* v. *Parker*, 192 U. S. 73, 86; *United States* v. *Shreveport Gr. & El. Co.*, 287 U. S. 77, 83; *Hamilton* v. *Rathbone*, 175 U. S. 414, 421. Still, if canons of construction are to be called into play, that of strict construction cannot over-balance the legislative history of the act itself, the administrative construction given the act in this connection, nor the legislative construction of the act. Petitioner should not ask the Court to substitute for the policy shown to have been adopted by Congress, the judge-made rule of strict construction.[53] Petitioner would have the Court, under the cloak of strict construction, amend Section 26 retroactively, Congress amended it in 1938[54] only prospectively.

---

an element in decision, and effective, maybe, when all other tests of meaning have been employed which experience has afforded, and which it is the duty of the courts to consider when rights are claimed under a statute." *Citizens' Bank* v. *Parker*, 192 U. S. 73, 85-86. *Cf. Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 89.

[53] "That [the judicial] department has no will, in any case. If the sound construction of the act be, that it exempts the trade of the Bank, as being essential to the character of a machine necessary to the fiscal operations of the government, from the control of the States, Courts are as much bound to give it that construction, as if the exemption had been established in express terms. Judicial power, as contradistinguished from the power of the laws, has no existence. Courts are the mere instruments of the law, and can will nothing. When they are said to exercise a discretion, it is a mere legal discretion, a discretion to be exercised in discerning the course prescribed by law; and, when that is discerned, it is the duty of the Court to follow it. Judicial power is never exercised for the purpose of giving effect to the will of the Judge; always for the purpose of giving effect to the will of the Legislature; or in other words, to the will of the law." *Osborn* v. *The Bank*, 9 Wheat. 738, 866.

[54] Revenue Act of 1938, § 817, 12 U. S. C. § 931a, *supra*, p.

Furthermore, the Federal Farm Loan Act, it has been held, carries out a public purpose.[55] Exemptions begotten from motives of public policy are not to be narrowly construed.[56]

B. Petitioner attempts to glean support for its restriction of the language of Section 26 by reason of its provision exempting the bonds and income derived therefrom from state taxation. Petitioner argues (Petr.'s Brf. pp. 12-14) (1) that the exemption from state taxation granted by Section 26 was merely intended to be declaratory of the constitutional immunity that would exist in the absence of a Congressional declaration to the contrary; (2) that under *Wilcutts* v. *Bunn* the states have constitutional power to tax capital gains on the sale of Federal bonds "in the absence of a Congressional declaration to the contrary" (Petr.'s Brf. p. 14); (3) that consequently Section 26 intended to exempt mere interest and not capital gains.

There are a number of answers to this involved argument:

In the first place, petitioner commits the logistic fallacy of *petitio principii*, for this question does not arise "in the absence of a Congressional declaration to the contrary". Rather, Congress expressly exempted the bonds "and the income derived therefrom". The argument therefore does

---

[55] *Krauthoff* v. *Kansas City Joint Stock Land Bank* (8th C. C. A. 1929), 31 F. 2d, 75, 78; *Smith* v. *Kansas City Title & Trust Co.*, 255 U. S. 180, 207-209. These purposes are fully set out above, pp. ———.

[56] *Helvering* v. *Bliss*, 293 U. S. 144, 150-151; *Pittman* v. *H. O. L. C.* 308 U. S. 21, 31; *United States* v. *Pleasants*, 305 U. S. 357, 360, affirming 86 C. Cls. 679, 22 F. S. 964, 971; *McFeely* v. *Commr.*, 296 U. S. 102, 111; *Trinidad* v. *Sagrada Orden de Predicadores*, 263 U. S. 578, 581-582; *White* v. *United States* (C. Cls. 1938), 86 C. Cls. 728, 743, 22 F. S. 821, 829; *Federal Land Bank* v. *Crosland*, 261 U. S. 374, 377; *Roche's Beach, Inc.* v. *Commr.* (2d C. C. A. 1938), 96 F. (2d) 776, 779; *Union & New Haven Tr. Co.* v. *Eaton* (D. C. Conn. 1927), 20 F. (2d) 419, 421; *Y. M. C. A. Retirement Fund, Inc.* v. *Commr.* (1929), 18 B. T. A. 139, 146; *Heinz* v. *Commr.* (3d C. C. A. 1939), 101 F. (2d) 453.

not advance us, for the question remains that of whether Congress, by Section 26, intended to exempt capital gains. Secondly, Section 26 was not merely declaratory of the exemption which would have existed without it; Congress did not intend merely to declare what the law would have been as to state taxation if Section 26 had never been written. Rather, while there had been some uncertainty as to how far Congress could go, there is no uncertainty about the fact that it wanted to go the complete limit to protect its new venture from both state and Federal taxation. While true that some opponents of the exemption urged that Congress itself had no power to exempt *any* property from state taxation and that whatever exemption might be granted must stem from the Constitution itself, it was clearly recognized, even by these opponents, that the exemption section *did* assert a power on the part of Congress to exempt property from taxation which would not without it be exempt under the Constitution. It was opposed for that very reason.[57] On the other hand, proponents of the bill urged that Congress had the right in creating an instrumentality to protect it completely from taxation by states, and that unless Congress acted to do so, it left the states free to tax.[58]

---

[57] That was a principal ground for Senator Cummins' moving to strike the entire exemption section (Cong. Record, Vol. 53, p. 7245). Among other things, he said: "I do assert, however, with the utmost confidence, that Congress cannot in any form or in any way by declaration remove property from the power of state taxation. It has never been attempted before, I believe. I have never heard it asserted *until I found it in this bill.*"

[58] Senator Hollis, in charge of the bill in the Senate, cited and quoted from *Van Allen* v. *The Assessors*, 3 Wall. 573, 582, to support this contention, and then said (Cong. Record, Vol. 53, p. 7313):

> "When the Government occupies a field which the Constitution permits it to occupy, it may occupy it exclusive of state occupation, or may occupy it with such conditions as it chooses through its Congress to impose. That is what was decided in the case of Van Allen * * * Therefore, if we have a right to establish this instrumentality to help out a proper govern-

The dispute in Congress as to the power of the Federal Government to exempt the bonds and their income from state taxation was settled by this Court in *Smith* v. *Kansas City Title & Trust Co., supra.* In that case Section 26 was considered "the real issue sought to be settled here." (p. 211.) It was said "to be an invasion of state authority to extend the tax exemption so as to restrain the power of the state." (p. 212.) But this Court then squarely held (p. 211):

> "Deciding as we do that these institutions have been created by Congress within the exercise of its legitimate authority, we think the power to make the securities here involved tax exempt necessarily follows. This principle was settled in *McCulloch* v. *Maryland* and *Osborn* v. *Bank, supra.*
>
> "That the Federal Government can, if it sees fit to do so, exempt such securities from taxation, seems obvious upon the clearest principles . . .
>
> "The same principle has been recognized in the National Bank Cases, declaring the power of the states to tax the property and franchises of national banks *only to the extent authorized by the laws of Congress. Owensboro Natl. Bank* v. *Owensboro,* 173 U. S. 664, involved the validity of a franchise tax in Kentucky on national banks. In that case this court declared (pp. 668, 669) that the states were wholly without power to levy any tax directly or indirectly upon national banks, their property, assets or franchises, *except so far as the permissive legislation of Congress allowed such taxation; . . .*" (Italics added)

In the third place, the basis for petitioner's assumption that since under *Willcuts* v. *Bunn* capital gains on state bonds are not exempt from Federal taxation, capital gains on Federal bonds are not exempt from State taxation, is not

---

mental function, then we have a right to annex to it such conditions of taxation in favor of states or such exemption from taxation in favor of the instrumentality as Congress, in its discretion, as a matter of policy sees fit to impose. There cannot be any escape from that."

entirely clear.[59] As this Court has recently pointed out, the two types of immunity do not in all respects stand on parity. *Graves* v. *People of New York,* 306 U. S. 466, 478; *Helvering* v. *Gerhardt,* 304 U. S. 405. This fact was recognized as early as *McCulloch* v. *Maryland,* 4 Wheat. 316, and strongly reiterated in the very case upholding the constitutionality of the very section herein involved. *Smith* v. *Kansas City Title & Trust Co.,* 255 U. S. 180; see also *Federal Land Bank* v. *Crosland,* 261 U. S. 374.

It must not be forgotten that in the *Bunn* case the Court clearly indicated that had there been convincing evidence of an appreciable burden on the bonds from the tax, the result would have been different (p. 230). As to such burden, however, no evidence whatever was introduced; the Court was "left to the inadequate guidance of judicial notice" (p. 230). The Court's decision must be viewed in the light of this absence of convincing evidence, consideration of which was made necessary because of the absence also of any legislative expression indicating belief in the existence of such burden. Had there been such an expression it is respectfully submitted that (subject to the foregoing principle that state and Federal powers and immunities are not entirely reciprocal) the result would have been different. There is such an expression here.

At any rate, petitioner's argument shows the fallacy of trying to ascertain Congressional intent by delving into constitutional conjectures.

C. We have not overlooked the number of cases cited by petitioner (Brief, pp. 14-16), to support its contention that "broad statutory exemptions" are "inapplicable

---

[59] Petitioner's entire argument on this point simply reiterates in a slightly different form an argument first set forth by the author of the majority opinion in the related case, *Agricultural Securities Corp.* v. *Commissioner,* 39 B. T. A. 1103, 1109. There it was frankly predicated upon the exploded doctrine that similar principles govern state and Federal enjoyment of such immunities; and since capital gains from state bonds were not free from Federal tax, under *Willcuts* v. *Bunn,* therefore Congress did not intend to free capital gains on these farm loan bonds from its own tax.

where the subject matter of the exemption is involved only indirectly." We have here no such situation. As the court below stated (R. 134-5), the cases cited are readily distinguishable. In not one of them was there an exemption aimed squarely at and designed to defeat the very tax asserted, as here. Thus, in some instances, the tax was not upon property or income but upon the *transfer* by death or gift, whereas the exemption ran to the "bonds and the income derived therefrom" (*Igleheart* v. *Commr.*, 77 F. 2d 704, C. C. A. 5th), or the "principal and interest" (*Plummer* v. *Coler*, 178 U. S. 115; *Murdock* v. *Ward*, 178 U. S. 139; *Greiner* v. *Lewellyn*, 258 U. S. 384; *Hamersley* v. *United States*, 16 F. S. 768, C. Cls.; *Phipps* v. *Commr.*, 91 F. 2d 627, C. C. A. 10th, cert. den. 302 U. S. 742); in some the tax was on interest, whereas the exemption was restricted to direct property taxes (*Hale* v. *State Board*, 302 U. S. 95); in some the tax was an income tax on capital gains, whereas the exemption was only to "principal and interest" (*Central Hanover Bank & Trust Co.* v. *United States*, 14 F. S. 541, C. Cls., cert. den. 300 U. S. 678; *DeStuers* v. *Commr.*, 26 B. T. A. 201; *Roebling* v. *Commr.*, 37 B. T. A. 82); some involved tax upon income in the form of salary or dividends, whereas the exemption ran only to "principal and interest" of bonds (*Hitner* v. *Lederer*, 63 F. 2d 877, C. C. A. 3rd; *James* v. *Commr.*, 13 B. T. A. 764, 49 F. 2d 707, C. C. A. 2nd; *McGuire* v. *Commr.*, 32 B. T. A. 1075); one of them was a tax upon transfer by death, whereas the exemption was on the proceeds of an insurance policy of veterans insurance (*U. S. Trust Co.* v. *Helvering*, 307 U. S. 57); one of them, *Wilson* v. *Commr.*, 31 B. T. A. 1022, is not even remotely in point.

The present tax is levied by its plain words directly upon income (Revenue Act 1928, §11). The applicable exemption is of "income" which is derived from Federal farm loan bonds, and the words which convey it were, as already shown, chosen with a special view to exemption from this particular tax. See *supra*, pp. 23-24. Furthermore, the ex-

emption has been specifically construed already to prevent indirect taxation of its subject matter. *Federal Land Bank* v. *Crosland*, 261 U. S. 374; *West Co.* v. *Johnson*, 66 P. 2d, 1211, cert. den. 302 U. S. 638, rehearing denied, 303 U. S. 666; *cf. Pittman* v. *H. O. L. C.*, 308 U. S. 21.

IV. Petitioner is Estopped to Assert the Tax.

Even if Section 26 were susceptible of the construction contended for by petitioner, petitioner is nevertheless estopped to collect a tax in this case. As the courts below found (R. 42-43), respondent relied upon representations of a United States agency (the Farm Loan Board, a division of the Treasury Department) in making his purchases of bonds, "reasonably believing he was purchasing securities the income from which, in case of sale, would be exempt income." No interest was being paid by the banks whose bonds he purchased; he purchased them only for their prospective increment. (R. 41-42.)

The representations upon which respondent relied were authorized by the statute. Section 3 of the Federal Farm Loan Act (Appendix, p. 2) specifically makes it "the duty of the Federal Farm Loan Board * * * to prepare and distribute * * * circulars * * * advising investors of the merits and advantages of farm loan bonds." Although petitioner takes the position (note 14, Petr.'s Brf. p. 20) that this does not authorize representations that capital gains are exempt, nevertheless the exemption of capital gains is one of the "merits and advantages" of these bonds; and as the concurrent findings below show, it was the particular merit and advantage of the bonds in which respondent was concerned and upon which he relied.[60]

---

[60] We concede there would be no estoppel of the United States if its agents had no authority to make the representations they did. See *State of Utah* v. *United States*, 284 U. S. 534, 546; *Utah P. & L. Co.* v. *United States*, 243 U. S. 389, *et seq.*; *Wilber Nat. Bank* v. *United States*, 294 U. S. 120, 123. Here, as is pointed out in the text, there is express authority by statute for the representation.

Petitioner takes the position that whether such gain is exempt is a question of law rather than a question of fact; and reliance upon a representation of law is at the taxpayer's peril.[61] This should make no difference in a case of this kind. The proposition is discussed in *Staten Island, etc., Co.* v. *United States* (C. C. A. 2d, 1936), 85 Fed. (2) 68, 71. It was there held:

> "Between private parties it seems to be well established that equitable relief may be had where a mistake as to the plaintiff's legal rights is induced by misrepresentations, even though innocently made, if it is reasonable for the plaintiff to rely upon the presumably greater knowledge of the defendant. [Citing cases] It should make no difference that the United States is the party against whom rescission is sought."

Thus also in *Black* v. *Bolen* (1920, W. D. Okla.), 268 Fed. 427, writ of error dismissed *per cur.* (C. C. A. 8, 1921), 277 Fed. 1013, the Commissioner had advised the taxpayer that, a claim for abatement having been filed, it was unnecessary to file a claim for refund before instituting suit. This was purely a matter of law. When the taxpayer brought an action for refund, the Collector was held estopped to assert the necessity of previously filing a claim. See also *Glynn* v. *United States* (1897), 32 C. Cls. 100, 101. *Cf.*

---

[61] The cases relied upon in this connection are beside the mark. In *Sturm* v. *Boker*, 150 U. S. 312, 335, there was, as stated by the Court, only an expression of opinion on a matter of law, which did not mislead or induce defendants to change their position; in *Mutual Life Ins. Co.* v. *Phinney*, 178 U. S. 327, the question of estoppel was passed over because the Government otherwise had established no case; there were no "representations" in the sense in which that term is here used; the taxpayer had not, as here, changed its position in reliance on authorized representations by the Government's agent. *Helvering* v. *Gerhardt*, 304 U. S. 405, does not deal with estoppel but is possibly cited for the proposition that if a regulation holding income of a particular kind immune from tax is not authorized by the statute which does undertake to tax such income, the regulation must fall before the statute. p. 423. But this does not help in determining whether the representations herein involved were authorized by the statute.

Denver & R. G. R. Co. v. *United States* (1918), 53 C. Cls. 155, 166.

Many cases have held the United States to be estopped on facts no more compelling than those in the instant case. *Knight, Adm'r* v. *United States* (1900), 35 C. Cls. 129, 145; *Duval, Rec'r* v. *United States* (1889), 25 C. Cls. 46, 60; *Hartson* v. *United States*, 21 C. Cls. 451, 456; *United States* v. *Great No. Ry. Co.* (8th C. C. A., 1932), 57 F. (2d) 385, 393, aff'd 287 U. S. 144; *Branson* v. *Wirth*, 17 Wall. 32, 42; *William C. Atwater & Co.* v. *United States* (S. D. N. Y., 1936), 18 F. Supp. 564; *United States* v. *Bank of Metropolis*, 15 Pet. 377, 392; *Joseph Eichelberger & Co.* v. *Comm'r Int. Rev.* (5th C. C. A. 1937), 88 F. (2d) 874; *Cooke* v. *United States*, 91 U. S. 389, 398; *Eager* v. *United States* (1898), 33 C. Cls. 336, 338. *Cf. Ritter* v. *United States* (3d C. C. A., 1928), 28 F. (2d) 265, 267; *Woodworth* v. *Kales* (6th C. C. A., 1928), 26 F. (2d) 178, 180; *Lindsey* v. *Hawes*, 2 Black 554, 560.

V. CONCLUSION.

The decision of the court below should be affirmed.

Respectfully submitted,

W. Glenn Harmon,
Ernest L. Wilkinson,
John W. Cragun,
J. Edward Johnson,
Counsel for Respondent.

BLANK PAGE

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 8 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner*,

v.

ASHBY OLIVER STEWART, *Respondent*.

APPENDIX TO

Brief For Respondent.

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

BLANK PAGE

INDEX TO APPENDIX

Page

Drafts of Section 26 During Course of Its Enactment.....24-26

Excerpts from Reports Disclosing Purpose of Farm Loan Act.....29-30
Excerpt from House Rep. No. 630, 64th Cong., 1st Sess..... 29
Excerpt from Senate Doc. No. 380, 63rd Cong., 2nd Sess..... 29
Excerpt from Senate Rep. No. 144, 64th Cong., 1st Sess..... 30

Exemption Statutes:
Group One, Exempting Bonds Only..... 6
Act of Mar. 4, 1900, c. 41, 31 Stat. 45, 48..... 6
Act of June 28, 1902, c. 1302, 32 Stat. 481, 484..... 7
Act of Aug. 5, 1909, c. 6, 36 Stat. 11, 117..... 7
Act of June 25, 1910, c. 386, 36 Stat. 814, 817..... 7

Group Two, Exempting Principal and Interest..... 7
Act of July 14, 1870, c. 256, 16 Stat. 272..... 7
Act of Dec. 23, 1913, c. 6, 38 Stat. 251, 269..... 8
First Liberty Loan Act (1917), c. 4, 40 Stat. 35..... 8
Second Liberty Loan Act (1917), c. 56, 40 Stat. 288, 291..... 8
Third Liberty Loan Act (1918), c. 44, 40 Stat. 502..... 9
Fourth Liberty Loan Act (1918), c. 142, 40 Stat. 844, 845..... 9
Victory Liberty Loan Act (1919), c. 100, 40 Stat. 1309, 1310.. 10

Group Three, Exempting Income Derived from Capital and Surplus 11
Federal Reserve Act (1913), 38 Stat. 251, 258..... 11
Banking Act (1935), c. 614, 49 Stat. 684, 696..... 11
Farm Tenant Act (1937), c. 517, 50 Stat. 522, 528..... 11
Federal Credit Union Act (1934), c. 750, 48 Stat. 1216, 1222.. 12
Agricultural Adjustment Act (1938), c. 30, 52 Stat. 31, 75.... 12

Group Four, Exempting Income Derived from Capital and Surplus But Only Interest Derived from Bonds 12

War Finance Corp. Act (1918), c. 45, 40 Stat. 506, 511..... 12
Reconstruction Finance Corp. Act (1932), c. 8, 47 Stat. 5, 9... 13
Federal Home Loan Bank Act (1932), c. 522, 47 Stat. 725, 735 13
Home Owners' Loan Act (1933), c. 64, 48 Stat. 128, 130..... 14
United States Housing Act (1937), c. 896, 50 Stat. 888, 890, 898 14
Federal Savings and Loan Ins. Corp. Act (1934), c. 847, 48 Stat. 1246, 1257 15
Federal Deposit Ins. Corp. Act (1933), c. 89, 48 Stat. 162, 168, 177 15
Farm Credit Act (1933), c. 98, 48 Stat. 257, 267..... 16
National Mortgage Associations Act (1938), c. 13, 52 Stat. 8, 24 16

Group Five, Exempting Income Derived from Capital and Surplus, and Also Income Derived from Bonds..... 17

Farm Loan Act (1916), c. 245, 39 Stat. 360, 380..... 17
Intermediate Credit Bank Act (1923), c. 252, 42 Stat. 1454, 1459 17
Farm Mortgage Corporation Act (1934), c. 7, 48 Stat. 344, 347 18
Commodity Credit Corporation Act (1938), c. 44, 52 Stat. 107, 108 18

Page

Excerpts from Brief of Government, Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509 20-23

Federal Farm Loan Act of 1916 (c. 245, 39 Stat. 360) 1
Section 3 2
Section 12 2
Section 13 2
Section 16 ..... 2, 3
Section 20 3
Section 21 ..... 3, 4
Section 22 4

Revenue Act of 1916 (c. 463, 39 Stat. 758, 776) 4
Section 4 4
Section 22 5

Revenue Act of 1918 (c. 18, 40 Stat. 1057) 5
Section 213(b)(4) 5

Revenue Act of 1928 (c. 852, 45 Stat. 797) 5
Section 22(a) 5
Section 22(b)(4) 6

Statements at Hearings and on Floor of Congress During Passage of Farm Loan Act:
T. C. Atkeson before Joint Hearings, Sub-Com., Committees on Banking and Currency, pp. 263-4 27
Senator Cummins, Cong. Record, Vol. 53, p. 7311 26
Myron T. Herrick, Cong. Record, Vol. 53, p. 6850 27-28
Senator Hollis, Cong. Record, Vol. 53, pp. 6696-7 28
Senator Lodge Cong. Record, Vol. 53, p. 7128 26
Rep. Moss, Joint Hearings, supra, p. 95 28

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner*,

v.

ASHBY OLIVER STEWART, *Respondent*.

APPENDIX TO

Brief For Respondent.

PROVISIONS OF THE FEDERAL FARM LOAN ACT OF 1916.

C. 245, 39 Stat. 360, mentioned in the course of the brief and not set out under statutes involved.

Sec. 3. That there shall be established at the seat of government in the Department of the Treasury a bureau charged with the execution of this Act and of all Acts amendatory thereof, to be known as the Federal Farm Loan Bureau, under the general supervision of a Federal Farm Loan Board.

* * *

It shall be the duty of the Federal Farm Loan Board to prepare from time to time bulletins setting forth the principal features of this Act and through the Department of Agriculture or otherwise to distribute the same, particularly to the press, to agricultural journals, and to farmers' organizations; to prepare and distribute in the same manner circulars setting forth the principles and advantages of amortized farm loans and the protection afforded debtors under this Act, instructing farmers how to organize and conduct farm loan associations, and advising investors of the merits and advantages of farm loan bonds; * * *

Sec. 12. That no Federal land bank organized under this Act shall make loans except upon the following terms and conditions:

* * *

Second. Every such mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments sufficient to cover, first, a charge on the loan, at a rate not exceeding the interest rate in the last series of farm loan bonds issued by the land bank making the loan; second, a charge for administration and profits at a rate not exceeding one per centum per annum on the unpaid principal, said two rates combined constituting the interest rate on the mortgage; * * *

Sec. 13. That every Federal land bank shall have power, subject to the limitations and requirements of this Act—

First. To issue, subject to the approval of the Federal Farm Loan Board, and to sell farm loan bonds of the kinds authorized in this Act, to buy the same for its own account, and to retire the same at or before maturity.

* * *

Sec. 16. * * *

Except as otherwise provided, joint stock land banks shall have the powers of, and be subject to all the restric-

tions and conditions imposed on, Federal land banks by this Act, so far as such restrictions and conditions are applicable: *Provided, however,* That the Government of the United States shall not purchase or subscribe for any of the capital stock of any such bank; and each shareholder of any such bank shall have the same voting privileges as holders of shares in national banking associations.

* * *

Joint stock land banks shall in no case charge a rate of interest on farm loans exceeding by more than one per centum the rate of interest established for the last series of farm loan bonds issued by them.

Form of Farm Loan Bonds

Sec. 20.

* * *

In order to furnish farm loan bonds for delivery at the Federal land banks and joint stock land banks, the Secretary of the Treasury is hereby authorized to prepare suitable bonds in such form, subject to the provisions of this Act, as the Federal Farm Loan Board may approve, such bonds when prepared to be held in the Treasury subject to delivery upon order of the Federal Farm Loan Board. The engraved plates, dies, bed-pieces, and so forth, executed in connection therewith shall remain in the custody of the Secretary of the Treasury.

* * *

Special Provisions of Farm Loan Bonds

Sec. 21.

* * *

Every farm loan bond issued by a Federal land bank shall be signed by its president and attested by its secretary, and shall contain in the face thereof a certificate signed by the Farm Loan Commissioner to the effect that it is issued under the authority of the Federal Farm Loan Act, has the approval in form and issue of the Federal Farm Loan Board, and is legal and regular in all respects;

that it is not taxable by National, State, municipal, or local authority; that it is issued against collateral security of United States Government bonds, or indorsed first mortgages on farm lands, at least equal in amount to the bonds issued; and that all Federal land banks are liable for the payment of each bond.

Sec. 22. * * *

Amortization and other payments on the principal of first mortgages held by a farm loan registrar as collateral security for the issue of farm loan bonds shall constitute a trust fund in the hands of the Federal land bank or joint stock land bank receiving the same, and shall be applied or employed as follows:

In the case of a Federal land bank—

* * *

(b) To purchase at or below par farm loan bonds issued by said bank or by any other Federal land bank.

* * *

In the case of a joint stock land bank—

* * *

(b) To purchase at or below par farm loan bonds.

PROVISIONS OF THE REVENUE ACT OF 1916.

C. 463, 39 Stat. 758, 776.

Sec. 4. The following income shall be exempt from the provisions of this title:

* * *

interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen; * * *

Sec. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

PROVISIONS OF THE REVENUE ACT OF 1918.

C. 18, 40 Stat. 1057.

Sec. 213. That for the purposes of this title * * * the term "gross income"—

(b) Does not include the following items, * * *

(4) Interest upon * * * (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; * * *

[Similar provisions were contained in Section 213 (b) (4) of the Revenue Act of 1921; the same section of the Revenue Act of 1924, and the same section of the Revenue Act of 1926.]

PROVISIONS OF THE REVENUE ACT OF 1928.

C. 852, 45 Stat. 797.

Sec. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * *

(4) *Tax-free interest.*—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes;

* * *

EXEMPTION STATUTES.

Group One.

Statutes Exempting Only the Bonds.

2% Consol Bonds, Act of March 14, 1900, c. 41, 31 Stat. 45, 48 § 11, authorizing issuance of 2% consol bonds provided that such bonds should

> " . . . be exempt from the payment of all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal, or local authority."

2% PANAMA CANAL TOLL BONDS, Act of June 28, 1902, c. 1302, 32 Stat. 481, 484, § 8, authorizing 2% Panama Canal toll bonds provided that:

> ". . . the bonds herein authorized shall be exempt from all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal or local authority: . . ."

3% PANAMA CANAL TOLL BONDS, Act of August 5, 1909, c. 6, 36 Stat. 11, 117, § 39, authorizing 3% Panama Canal toll bonds provided that:

> ". . . the bonds herein authorized shall be exempt from all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal, or local authority: . . ."

POSTAL SAVINGS BONDS, Act of June 25, 1910, c. 386, 36 Stat. 814, 817, § 10, providing for postal savings bonds stated that:

> ". . . the bonds herein authorized shall be exempt from all taxes or duties of the United States as well as from taxation in any form by or under state, municipal, or local authority: . . ."

It is to be noted that each of the above statutes refers only to the bonds; nevertheless all bonds issued thereunder stated on their face that the exemption covered *interest* as well. (See Treas. Dept. Cir. No. 300, 1903, App. E, p. 52, *et. seq.*)

Group Two.

Statutes Expressly Exempting Interest as Well as Principal.

Act of July 14, 1870, c. 256, 16 Stat. 272, § 1, provided:

> ". . . all of . . . said several classes of bonds *and the interest thereon* shall be exempt from the payment of

all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal, or local authority; . . ." (Italics added.)

Act of December 23, 1913, c. 6, 38 Stat. 251, 269, § 18, 12 U. S. C. § 447, provided for issuance of Treasury notes and bonds. It provided that the Treasury notes should:

". . . be exempt *as to principal and interest* from the payment of all taxes and duties of the United States except as provided by this Act, as well as from taxes in any form by or under State, municipal, or local authorities." (Italics added.)

The act further provided that the bonds should be subject to the same terms and conditions as the 3% United States bonds then outstanding, they being the 3% Panama Canal toll bonds.

First Liberty Loan Act of April 24, 1917, c. 4, 40 Stat. 35, § 1, 31 U. S. C. § 746.

"The principal and *interest* thereof shall be payable in United States gold coin of the present standard of value and shall be exempt, both as to principal and *interest*, from all taxation, except estate or inheritance taxes, imposed by authority of the United States, or its possessions, or by any State or local taxing authority; but such bonds shall not bear the circulation privilege." (Italics added.)

Second Liberty Loan Act of September 24, 1917, c. 56, 40 Stat. 288, 291, § 7, 31 U. S. C. § 747.

". . . All such bonds and certificates shall be exempt, both as to principal and *interest* from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing

authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. . . ." (Italics added)

THIRD LIBERTY LOAN ACT of April 4, 1918, c. 44, 40 Stat. 502, 31 U. S. C. § 747.

N. B. These bonds were issued under enactment by way of amendment of the Second Liberty Loan Act. Hence, the exemptions are identical with the latter.

FOURTH LIBERTY BOND ACT of July 9, 1918, c. 142, 40 Stat. 844, 845, § 3, 31 U. S. C. § 750.

N. B. These bonds were issued under enactment by way of amendment of the Second Liberty Loan Act. Hence, the exemptions are identical with the latter except the following:

"Sec. 3. That notwithstanding the provisions of the Second Liberty Bond Act, as amended by the Third Liberty Bond Act, or of the War Finance Corporation Act, bonds and certificates of indebtedness of the United States payable in any foreign money or foreign moneys, and bonds of the War Finance Corporation payable in any foreign money or foreign moneys exclusively or in the alternative, shall, if and to the extent expressed in such bonds at the time of their issue, with the approval of the Secretary of the Treasury, while beneficially owned by a nonresident alien individual, or by a foreign corporation, partnership, or association, not engaged in business in the United States, be exempt both as to principal and *interest* from any and all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the

United States, or by any local taxing authority." (Italics added.)

VICTORY LIBERTY LOAN ACT of March 3, 1919, c. 100, 40 Stat. 1309, 1310, § 1, 31 U. S. C. § 753 (b), amending § 18 (b) of the Second Liberty Loan Act, *supra*, to read as follows:

"(b). The notes herein authorized may be issued in any one or more of the following series as the Secretary of the Treasury may prescribe in connection with the issue thereof:

"(1) Exempt, both as to principal and *interest*, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority;

"(2) Exempt, both as to principal and *interest*, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations;

"(3) Exempt, both as to principal and *interest*, as provided in paragraph (2); and with an additional exemption from the taxes referred to in clause (b) of such paragraph, of the interest on an amount of such notes the principal of which does not exceed $30,000, owned by any individual, partnership, association, or corporation; or

"(4) Exempt, both as to principal and *interest*, from all taxation now or hereafter imposed by the United States, any State or any of the possessions of the United States, or

by any local taxing authority, except (a) estate or inheritance taxes, and (b) all income, excess-profits, and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations or corporations." (Italics added.)

Group Three.

Statutes Exempting "Income" Derived from Capital and Surplus.

FEDERAL RESERVE ACT of December 23, 1913, c. 6, 38 Stat. 251, 258, § 7, 12 U. S. C. § 531:

"Federal reserve banks, including the capital stock and surplus therein, *and the income derived therefrom* shall be exempt from Federal, State, and local taxation, except taxes upon real estate." (Italics added.)

BANKING ACT of 1935, creating the Federal Deposit Insurance Corporation, June 16, 1933, as amended by Banking Act of 1935, c. 614, 49 Stat. 684, 696, § 101 [§ 12B (l)(9)], 12 U. S. C. § 264 (l)(9), covering new banks organized by the Federal Deposit Insurance Corporation:

". . . Notwithstanding any other provision of law the new bank, its franchise, property, *and income* shall be exempt from all taxation now or hereafter imposed by the United States . . ." (Italics added.)

THE BANKHEAD-JONES FARM TENANT ACT of July 22, 1937, c. 517, 50 Stat. 522, 528, Title IV, § 40(i), 7 U. S. C. § 1014(i) relating to the Farmers' Home Corporation:

"Sec. 40.(i) The Corporation, including its franchises, its capital, reserves, and surplus *and its income* and property shall, except as otherwise provided in section 50(a), be exempt from all taxation now or hereafter imposed by the United States or any State, Territory, District, dependency, or political subdivision." (Italics added.)

FEDERAL CREDIT UNION ACT (June 26, 1934, c. 750, 48 Stat. 1216, 1222, § 18, 12 U. S. C. § 1768) as amended by Act of December 6, 1937, c. 3, 51 Stat. 4, § 4:

"Sec. 18. The Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, *and their income* shall be exempt from all taxation now or hereafter imposed by the United States . . ." (Italics added.)

AGRICULTURAL ADJUSTMENT ACT of 1938, establishing Federal Crop Insurance Corporation, Act of February 16, 1938, c. 30, 52 Stat. 31, 75, § 511 of Title V, 7 U. S. C. § 1511:

"Sec. 511. The Corporation, including its franchise, its capital, reserves, and surplus, *and its income* and property, shall be exempt from all taxation now or hereafter imposed by the United States or by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority." (Italics added.)

Group Four.

Statutes Exempting "Income" Derived from Capital and Surplus; But Only "Interest" Derived from Bonds.

WAR FINANCE CORPORATION ACT of April 5, 1918, c. 45, 40 Stat. 506, 511, § 16, 15 U. S. C. §§ 344, 345:

"Sec. 16. That any and all *bonds* issued by the Corporation shall be *exempt, both as to principal and interest,* from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, corporations, or associations. *The interest* on an amount of such bonds the principal of which does not

exceed in the aggregate $5,000, owned by any individual, partnership, corporation, or association, shall be exempt from the taxes referred to in clause (b). The *Corporation* including its franchise and the capital and reserve or surplus thereof, *and the income derived therefrom,* shall be exempt from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except that any real property of the Corporation shall be subject to State, county, or municipal taxes to the same extent, according to its value, as other real property is taxed." (Italics added.)

RECONSTRUCTION FINANCE CORPORATION ACT of January 22, 1932, c. 8, 47 Stat. 5, 9, § 10, 15 U. S. C. § 610:

"Any and all notes, debentures, bonds, or other such obligations issued by the corporation shall be exempt both as to principal *and interest* from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. *The corporation,* including its franchise, its capital, reserves, and surplus, *and its income* shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed." (Italics added.)

FEDERAL HOME LOAN BANK ACT of July 22, 1932, c. 522, 47 Stat. 725, 735, § 13, 12 U. S. C. § 1433:

"Any and all notes, debentures, bonds, or other such obligations issued by any bank shall be exempt both as to principal *and interest* from all taxation (except surtaxes,

estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency or possession thereof, or by any State, county, municipality, or local taxing authority. *The bank*, including its franchise, its capital, reserves, and surplus, its advances, *and its income* shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that in any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed." (Italics added.)

HOME OWNERS' LOAN ACT of June 13, 1933, c. 64, 48 Stat. 128, 130, § 4(c), 12 U. S. C. § 1463(c):

". . . The bonds issued by the Corporation under this subsection shall be exempt, both as to principal *and interest*, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any District, Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The *Corporation*, including its franchise, its capital, reserves and surplus, and its loans *and income*, shall likewise be exempt from such taxation; . . ." (Italics added.)

UNITED STATES HOUSING ACT of September 1, 1937, c. 896, 50 Stat. 888, 890, 898, §§ 5(c), 20(b), 42 U. S. C. §§ 1405(c), 1420(b):

"Sec. 5. (c) *The Authority*, including but not limited to its franchise, capital, reserves, surplus, loans, *income*, assets, and property of any kind, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, county, municipality, or local taxing au-

thority. *Obligations, including interest thereon,* issued by public housing agencies in connection with low-rent-housing or slum-clearance projects, and the *income derived by such agencies* from such projects, shall be exempt from all taxation now or hereafter imposed by the United States.

"Sec. 20. (b) Such obligations shall be exempt, both as to principal *and interest,* from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority." (Italics added.)

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, Act of June 27, 1934, c. 847, 48 Stat. 1246, 1257, § 402 (e), 12 U. S. C. § 1725 (e):

"All notes, bonds, debentures, or other such obligations issued by the Corporation shall be exempt, both as to principal *and interest,* from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, . . . *The Corporation,* including its franchise, capital, reserves, surplus, *and income,* shall be exempt from all taxation now or hereafter imposed by the United States, . . . " (Italics added.)

FEDERAL DEPOSIT INSURANCE CORPORATION, Act of June 16, 1933, c. 89, 48 Stat. 162, 168, 177, § 8 [§ 12 B (p)], 12 U. S. C. § 264 (p):

"All notes, debentures, bonds, or other such obligations issued by the Corporation shall be exempt, both as to principal *and interest,* from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, . . . *The Corporation,* including its franchise, its capital, reserves, and surplus, *and its income,* shall be exempt from all taxation now or hereafter imposed by the United States, . . . " (Italics added.)

FARM CREDIT ACT of June 16, 1933, c. 98, 48 Stat. 257, 267, § 63, 12 U. S. C. § 1138 c:

"Sec. 63. The Central Bank for Cooperatives, and the Production Credit Corporations, Production Credit Associations, and Banks for Cooperatives, organized under this Act, and their obligations, shall be deemed to be instrumentalities of the United States, and as such, any and all notes, debentures, bonds, and other such obligations issued by such banks, associations, or corporations shall be exempt both as to principal *and interest* from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority. Such banks, associations, and corporations, their property, their franchises, capital, reserves, surplus, and other funds, *and their income,* shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such banks, associations, and corporations shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed." (Italics added.)

NATIONAL MORTGAGE ASSOCIATIONS, established by Act of February 3, 1938, c. 13, 52 Stat. 8, 24, § 8, 12 U. S. C. § 1722:

"Sec. 8. Section 307 of such Act is amended to read as follows:

" 'Sec. 307. All notes, bonds, debentures, or other obligations issued by any national mortgage association shall be exempt, both as to principal *and interest,* from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. *Every*

national mortgage association, including its franchise, capital, reserves, surplus, mortgage loans, *income*, and stock, shall be exempt from taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. Nothing herein shall be construed to exempt the real property of such association from taxation by any State, county, municipality, or local taxing authority to the same extent according to its value as other real property is taxed.' " (Italics added.)

Group Five.

Statutes Exempting "Income" Derived from Capital and Surplus and Also "Income" Derived from Bonds.

FEDERAL FARM LOAN ACT of July 17, 1916, c. 245, 39 Stat. 360, 380, § 26, 12 U. S. C. § 931:

"That *every Federal land bank* and every national farm loan association, including the capital and reserve or surplus therein and *the income derived therefrom*, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, *and as such they and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation." (Italics added.)

FEDERAL INTERMEDIATE BANKS, established under Act of March 4, 1923, c. 252, Title II, 42 Stat. 1454, 1459, § 2, (amending the Farm Loan Act of 1916):

" 'Sec. 210. That the privileges of tax exemption accorded under Section 26 of this Act shall apply also to

each Federal Intermediate Credit Bank, including its capital, reserve, or surplus, *and the income derived therefrom*, and the debentures issued under this title shall be deemed and held to be instrumentalities of the Government *and shall enjoy the same tax exemptions as are accorded farm loan bonds in said section.*'" (Italics added.)

FEDERAL FARM MORTGAGE CORPORATION ACT of January 31, 1934, c. 7, 48 Stat. 344, 347, § 12, as amended February 26, 1934, c. 33, 48 Stat. 360, 12 U. S. C. § 1020 f:

"(a) *The corporation*, including its franchise, its capital, reserves, and surplus, *and its income* shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

"(b) Mortgages executed to the Land Bank Commissioner and mortgages held by the Corporation, and the credit instruments secured thereby, and *bonds issued by the Corporation* under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they *and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation (except surtaxes, estate, inheritance, and gift taxes)." (Italics added.)

COMMODITY CREDIT CORPORATION, Act of March 8, 1938, c. 44, 52 Stat. 107, 108, § 5, 15 U. S. C. § 713a-5:

"SEC. 5. Bonds, notes, debentures, and other similar obligations issued by the Commodity Credit Corporation under the provisions of this Act shall be deemed and held to be in-

strumentalities of the Government of the United States, and as such they *and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation (except surtaxes, estate, inheritance, and gift taxes). *The Commodity Credit Corporation,* including its franchise, its capital, reserves, and surplus, *and its income* shall be exempt from all taxation now or hereafter imposed by the United States . . . ." (Italics added.)

Excerpts from Brief of Government in Merchants Loan and Trust Co. v. Smietanka, 255 U. S. 509.

(The issue in this case was the taxability under the Income Tax Act of September 8, 1916, as amended October 3, 1917, of capital gain derived from stock acquired before March 1, 1913, and sold February 2, 1917. The Government sought to tax the difference between the value of the stock as of March 1, 1913, and its selling price, as income. The taxpayers resisted upon the ground that gain derived from capital assets through a conversion thereof is not income unless segregated from the capital and treated as income. The following excerpts are from the brief filed by the Government.)

(From pp. 9-10)

"Apparently, however, Congress recognized that such gains [from sales of real and personal property under the acts here in question] *received* [italics theirs] in a given year would, in many cases, have been accruing during a period of years a part of which was before the adoption of the sixteenth amendment. Before the adoption of that amendment *income derived from property* [italics ours] could not be taxed except by apportionment. Congress accordingly took March 1, 1913, as a starting point, and has treated all subsequent gains in the value of property as it was on that date as taxable income received when converted into cash. Ordinarily when property is sold the difference between the cost and selling price measures the gains which have been accruing during the period of ownership and which *are received when a sale is made* [italics theirs]. Congress seems to have felt that it ought not, if it could, tax so much of these gains as consist of increase of value occurring prior to the adoption of the amendment. The gains *finally realized by a sale* [italics ours] were regarded as what had been *earned,* through a period of years, *by the capital originally invested* [italics ours]. The value of the

property on a given date would include the portion of the profits finally realized which had been earned prior to that date. Hence it was determined to treat as taxable income only the difference between the value of the property on March 1, 1913, and the selling price . . . ."

* * *

(From pp. 10-12)

In defining "income" the brief says:

"* * * *Indeed, whatever comes to one as the earnings of labor or capital is, as it is received, income,* [italics ours] and becomes capital as soon as it has been received. A man's capital, at a given time, is what he had originally plus the accumulated income which he has added to it. As said in *Eisner* v. *Macomber,* (252 U. S. 189, 206):

> "For the present purpose we require only a clear definition of the term 'income,' as used in common speech, in order to determine its meaning of the amendment.

"Every man who sells a piece of property considers that the difference between the selling price and what the property has cost him is what he has made or *what the capital invested has earned for him* [italics ours]. It is this common-sense meaning which this court has given to the word 'income.'

"The question then is, What, in common speech, is understood to be included in income? * * *

"It is, of course, conceded that nothing is now income which was not income before the adoption of the sixteenth amendment. The effect of that amendment was simply to make taxable, without apportionment, certain classes of income which were not before so taxable. *Income* [italics theirs] means now the same that it meant before the adoption of that amendment, the effect of which is to enable Congress to tax income of all kinds without resorting to the

cumbrous method of taxing it by apportionment among the States. *It is true that before this amendment such income as is now involved had been held not taxable without apportionment* [italics ours]. This, however, was not because it was not *income* [italics theirs,] but because, on account of the source from which it was derived, a tax upon it had been held to be a direct tax and, therefore, subject to apportionment. The sixteenth amendment abolished all distinctions between the methods of taxing income by providing that income derived from any source should be taxable without apportionment. Certainly nothing which had previously been income was converted into something else by this constitutional amendment.

* * *

(From pp. 13-14)

"* * * The present tax is not an excise tax levied on the privilege of doing business. * * * It is applied broadly to the incomes of all individuals derived from any source whatever. Whether there is a liability for the tax depends solely upon whether there has been an income, and, in no sense, upon the character of the business from which the income is derived, or upon the fact that the recipient has been engaged in any business whatever. It applies to whatever is received and is included in the meaning which, in common language, is understood to attach to the word income.

* * *

(From p. 14)

"Whether income is the thing to be taxed or merely the thing by which the tax is to be measured, it must mean the same thing. It follows that whatever was income under the act of 1909 is income under the income tax laws, and is within the power of Congress to tax without apportionment."

(Here follows definition from *Stratton's Independence* v. *Howbert, Eisner* v. *Macomber* and *Doyle* v. *Mitchell,* and the brief continues:)

* * *

(From pp. 16-17)

"There was thus laid down a plain and simple rule that cannot be misunderstood. Income is something separate and distinct from the principal or capital *which produces it* [italics ours]. It is a gain or increase *derived from capital* [italics ours] and which has assumed a form in which it may be dealt with separate and apart from capital. When property is sold at an advance over what it has cost, the proceeds of sale include both the capital and the income which has resulted. The amount of income is to be ascertained by withdrawing from the proceeds of sale the amount of capital which has been invested. *What remains is the income which has been produced by or derived from the capital. When both are reduced to cash the income is something separate and distinct* [italics ours]. It can be used or expended without, in any way, using or expending the cash which, after the sale, represents the capital. So long as we have a capital asset the market value of which has advanced, there is the possibility of realizing profit or income by a sale of the asset. But, until such a sale, the possibility of profit can not be used in any way without using, in the same way, the capital asset. Hence nothing which falls short of separating the income from the capital can be said to result in the receipt by the owner of the income, and the present law taxes income only when it is received. * * *"

DRAFTS OF SECTION 26 DURING COURSE OF ITS ENACTMENT.

The first draft of the bill made by the United States Commission is as follows (Senate Committee Hearings, Committee on Banking and Currency, 1913-15, Vol. 35, p. 832):

> "The collateral trust bonds or debentures issued by any national farm-land bank organized under this act shall be forever exempt from the imposition of any tax, assessment or charge (other than income tax), whether national, State or municipal: *Provided*, That under the laws of the State under which said bank is operating, the mortgages or deeds of trust (or bonds or obligations secured thereunder) deposited as security for these collateral trust bonds or debentures of the said bank are likewise exempt under the laws of the said State from all taxes (other than income tax), assessment, or charges imposed by the said State or by any subdivision thereof or municipality thereunder; but no collateral trust bonds or debentures issued by a national farm-land bank shall have the privilege of such exemption from taxation under this act unless and until the mortgages and deeds of trust (or notes or obligations secured thereunder) which are deposited to secure the said collateral trust bonds or debentures of the said bank are likewise exempted from taxation by the State in which the bank is operating, as herein provided."

On more mature study this was broadened by the Commission so as to read as follows:

> "Sec. 18. That every national farm-land bank incorporated under the terms of this act and the capital stock and surplus therein and the *income derived therefrom* and the mortgages and deeds of trust (and the *notes and bonds* secured thereby) held by said bank and the national land-bank bonds issued by the same shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate." (Italics added) (Report, U. S. Com., Senate Doc. No. 380, 63rd Congress, 2d Session, Parts I and II, page 62.)

After the United States Commission submitted its report to Congress there was considerable criticism of the tax exemption feature of the proposed bill. The criticism was to the effect that it would be more justifiable to exempt from taxation the income from the farm loan bonds than the income from the capital of the joint stock land banks. (Hearings of Sub-committee, supra, pp. 97, 263-4, 831-2.)

The result was that when the bills from which the Farm Loan Act finally evolved were introduced in the Senate and the House they both contained the following provision: (S. 2986; H. R. 15004; H. R. Report No. 630, 64 Cong., 1st Sess.)

> "Sec. 23. [House Bill; in the Senate this provision was Sec. 29.] That every Federal Land Bank and every national farm-loan association, including the capital stock and reserve or surplus therein and the *income derived therefrom*, shall be exempt from Federal, State, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this act. First mortgages executed to Federal land banks, or to joint-stock land banks, under the provisions of this act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, and local taxation.
>
> "Farm loan bonds issued under the provisions of this act and the *income derived therefrom* shall be exempt from Federal, State, and local taxation." (Italics added)

After extended hearings before a joint sub-committee created by both Houses of Congress, the Committee on Banking and Currency of each House reported the bill to their respective Houses. The House Committee did not change the language of the above provision but the Senate Committee changed it so as to provide as follows:

> "Sec. 29. That every Federal land bank and every national farm loan association, including the capital stock and reserve or surplus therein and the *income*

> *derived therefrom,* shall be exempt from Federal, State, municipal and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and *the income derived therefrom* shall be exempt from Federal, State, municipal and local taxation." (Italics added) (Senate Report No. 144, 64th Cong. 1st Session, p. 32.)

The Senate Bill, including the above Section 29, (now Section 26) was the one finally enacted (S. 2986, 64th Cong. 1st Session; 12 U. S. C. § 931).

STATEMENTS BEFORE HEARINGS AND ON FLOOR OF CONGRESS DURING PASSAGE OF FARM LOAN ACT.

Proponents and opponents of the Farm Loan Act were unanimous in their interpretation as to the complete nature of the exemption. They disagreed only as to the wisdom thereof.

Senator Lodge of Massachusetts had this to say:

(Cong. Record, Vol. 53, p. 7128)

> "*Total tax exemption* is to be accorded to the bonds and mortgages of both Federal land banks and joint-stock land banks and in every other respect to the Federal land banks and national farm loan associations."

He contended that this would put other institutions and associations at a disadvantage.

Senator Cummins of Iowa opposed the tax exemption section in the following language (Cong. Record, Vol. 53, p. 7311):

"... But what is proposed here is that a capitalist of New York City who wants to buy a million dollars of the farm-loan bonds—because with the exemption from taxation we are providing they will be altogether the most attractive investment ever presented to the American people—*is not taxed at all;* and under any defensible system of taxation, if the City National Bank, of New York, or Kuhn, Loeb & Co. or any other of the great financial institutions desire to invest their capital in this very fascinating and profitable form, ought they not to pay taxes on their wealth? They would not have to return it, *even in their income accounts.*"

T. C. Atkeson, one of the agricultural experts who appeared before the joint sub-committee also protested against this exemption: (Joint Hearings before Sub-Committee of Committee on Banking and Currency of Senate and House, on Rural Credits, pp. 263-4.)

"The tax exemption includes the *profits* of these banks and the *profits* of individuals who make their investments solely for profit and who have no regard for the great national policy of conservation of agriculture and the perpetuation of our food supply.

"These exemptions are totally without the warrant of a great national beneficence. The nation might be justified in making these exceptions for the good of the people, but to make them for the benefit of the few bankers is special legislation of the rankest type."

He opposed the provisions because "so far as they provide for the special privilege of exemption from taxation it is a special legislation for private profits" (Ibid. pp. 263-264).

Senator Harding introduced into the Record letters written by former Governor Myron T. Herrick of Ohio, himself an authority on rural credits. In one of these letters, Governor Herrick says (Cong. Record, Vol. 53, p. 6850):

> "*The tax exemptions to be accorded are unparalleled.* . . . There is no foretelling the amount that might be attracted by this total tax exemption and the promise of Federal functionaries to pay high interest rates."

The proponents of the measure had the same understanding.

Typical is the language used by Senator Hollis in a direct reply to the contentions set forth by Governor Herrick (Cong. Record, Vol. 53, p. 6851) (Senator Hollis was in charge of the bill in the Senate.):

> "Governor Herrick speaks of 'jokers,' and points out two provisions that he calls 'jokers.' The first one that he calls a 'joker' is tax exemption. There is no joke about that. It is put right in the bill flatly; attention has been called to it in the report of the committee; I have called attention to it on the floor of the Senate; and there is no 'joker' about it . . . ."

Again, Senator Hollis said (p. 6696-7):

> ". . . and the government exempts from the income-tax law and from all Federal, State and local taxes, the capital stock of the Federal land banks—not of the joint stock land banks—and the mortgages and the bonds . . .
>
> "MR. LA FOLLETTE. Will the Senator state whether the bonds issued by the joint-stock banks are exempt from taxation as the bonds of the cooperative banks are?
>
> "MR. HOLLIS. Yes, the mortgages and the bonds are exempt in each instance . . ."

Representative Moss who was in charge of the bill in the House, had this to say:

> "I should oppose exempting the income of the banks from taxation. I believe in an income tax, and I think it would certainly be a very dangerous

precedent, after having just exacted an income-tax law, for Congress to create a corporation and exempt it from the income tax . . .

"But while I feel that the net income of the bank ought to be taxed under the income tax law, you understand that I am just as strongly in favor of exempting the bonds and the mortgages securing them from taxation."

(Hearings before aforesaid Joint Sub-Committee, p. 95.)

EXCERPTS FROM REPORTS DISCLOSING PURPOSE BACK OF FARM LOAN ACT.

Excerpt from Senate Document 380, 63d Congress, 2d Session, parts I and II, p. 24:

"Agriculture has been the one great national industry which has been without organization and has been absolutely helpless before the wonderful growth of our Nation. Therefore, the financing of our farms has become a national problem. The savings of the Nation must flow out to the farms in order to put agriculture on a proper basis as compared with other organized industries."

Excerpt from House Rep. No. 630, 64th Cong., 1st Sess., p. 3:

"Present Agencies Unable to Furnish Adequate Credit.

"That proper credit facilities are denied the farmer under present conditions is too apparent to need demonstration. Under present conditions the farmer often finds it difficult to obtain land-mortgage loans; such loans, when granted, carry a high rate of interest, in some sections a uniformly burdensome rate and in many instances an extortionate interest rate. Universally only short-time mortgages are available.

"That unreasonable rates and terms are imposed or oppression and extortion practiced it is needless to consider here. The potent fact is that the farmer, except in the few more fortunate sections, has not the service

nor the accommodation in mortgage credit to which his security entitles him, and, furthermore, under existing conditions he can not get it."

Excerpt from Sen. Rep. No. 144, 64th Congress, 1st Session, pp. 1-2:

"Modern Farming Requires Capital in Large Amounts—the American Farmer has the Best Security in the World, Productive Land—This Bill Enables the Farmer to Obtain Capital for Productive Purposes, at Low Rates and for Long Terms, on the Security of his Farm.

"Necessity for Farm Capital.

"The successful farmer becomes more of a business man each year. He must use more machinery, buy more fertilizer, and sow better seed. He must erect better buildings, raise better stock, and grow better crops. He must store his produce in order to sell in a high market. He must pay cash in order to buy cheap. If he wishes to keep his children on the farm, he must make his home attractive. All of this costs money. He must have ready cash.

"Difficulty of Securing Capital.

"The farmer applies to the nearest bank for a loan and offers his farm as security. The banker makes excuses. He doesn't know the farmer; he doesn't know the value of his farm; he doesn't like to tie his demand deposits up in long-term loans; his commercial customers, who carry a substantial line of deposits, have the first claim. These excuses are well founded.

"There may be additional excuses not so genuine, such as the scarcity of money, the hard hearts of the directors, unusual demands for loans, and the like. If the farmer gets a loan at all, he pays a high rate or he must be subject to foreclosure on short notice. He usually pays some one a large commission; he is subject frequently to substantial renewal fees; he is sometimes compelled to pay taxes on the mortgage as well as on the land; and he finds himself in the power of some hard-headed banker. He can not complain of this; it is the business of the banker to be hard-headed."

BLANK PAGE

BLANK PAGE

FILE COPY

Office - Supreme Court, U. S.
FILED
DEC 7 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 13

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

PETITION FOR REHEARING

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

BLANK PAGE

INDEX

PAGE

PETITION FOR REHEARING 1

CONCLUSION 10

CERTIFICATE OF COUNSEL UNDER RULE 33 11

Table of Cases

Barnes v. *Railroad Companies*, 17 Wall. 294 8

Caminetti v. *United States*, 242 U. S. 470 ..... 7, 8

Eisner v. *Macomber*, 252 U. S. 189 ..... 5, 7

Graves v. *Elliott*, 307 U. S. 383 6
Greenport Basin & Construction Co. v. *United States*, 260 U. S. 512 8

Hamilton v. *Rathbone*, 175 U. S. 414 7
Helvering v. *City Bank Farmers Trust Co.*, 296 U. S. 85 7

Mackenzie v. *Hare*, 239 U. S. 299 8
MacLaughlin v. *Alliance Insurance Co.*, 286 U. S. 244 5
Merchants Loan & Trust Co. v. *Smietanka*, 255 U. S. 509 ..... 5, 7, 10
Michigan v. *Michigan Trust Co.*, 286 U. S. 340 7

Olson v. *United States*, 292 U. S. 246 4
O. S. C. Line v. *United States*, 300 U. S. 98 7

Rodgers v. *United States*, 185 U. S. 83 9

Texas & N. O. R. Co. v. *Brotherhood*, 281 U. S. 548 4

United States v. *Commercial Credit Co.*, 286 U. S. 63 4
United States v. *Hartwell*, 6 Wall. 395 7
United States v. *Kirby Lumber Co.*, 284 U. S. 1 2
United States v. *Missouri Pacific R. Co.*, 278 U. S. 269 7

Washington v. *Miller*, 235 U. S. 422 9
Willcuts v. *Bunn*, 282 U. S. 216 ..... 6, 9

Statutes

Farm Loan Act, Sec. 3 3
Sec. 20, 21 4
Sec. 26 ..... 6, 8

Revenue Act of 1928, Sec. 24 (a), (b) 9
Revenue Act of 1938, Sec. 817 8

BLANK PAGE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 13

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

PETITION FOR REHEARING

Respondent respectfully petitions for a rehearing of the above cause, in which the opinion was delivered by Mr. Justice Douglas on November 12, 1940. As grounds therefor we desire to call the Court's attention to certain misconceptions of fact on the part of the Court which, if corrected, we believe ought to change the result. In addition, it is believed there has been a departure from well settled principles of law. We feel it our duty to point these things out so there will be no mistake in the Court's own mind as to the effect of the descision.

1. In ruling that respondent was not aided by administrative construction, the Court stated that the memorandum of the General Counsel of the Bureau of Internal Revenue was unpublished. (Op. p. 4.) This is incorrect. The opinion was

published by the Secretary of the Federal Farm Loan Board (also an arm of the Treasury Department, see *infra*), who addressed a letter to all joint stock land banks, citing and quoting the ruling of the General Counsel, R. 93-95.

Nor is it correct that the *Des Moines* opinion is "not precisely in point." There is no distinction whatever in any statute relating to this matter between a bank's own bonds and any other Federal farm loan bonds. *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, is still the law. The precise words of the statute here relied upon were construed in the *Des Moines* opinion by the administrative officials charged with enforcement of the act, and construed as to the identical type of gain here involved. Furthermore, that ruling was applied (R. 95-96, 100-101) to dealings in bonds of other banks.

Nor is the Court correct in its statement that no "established" administrative practice is shown. We do not rely merely on the opinion of the General Counsel in the *Des Moines* case, which (aside from the circulars, see *infra*) is the only instance of administrative construction referred to by the Court. Pursuant to the *Des Moines* ruling, an established and consistent course of administrative practice is shown in the fact that in excess of $100,000,000 profits on bonds by joint stock land banks (both of their own issue and those of other banks) have been held exempt to the banks. (R. 100-1.) The record itself shows statutory closing agreements with seven banks so profiting, under which it was agreed that no taxes were due. (Ex. 8, R. 99-100.) Furthermore, since 1913 the government has consistently exempted from taxation all capital gains made by Federal reserve banks, under a statute containing a like exemption with respect to "income derived therefrom." Indeed, the language of the Federal Reserve Act was the source for the language of Sec. 26. See Respondent's Brief, p. 24.

The record contains no administrative ruling at variance with this practice of the department, except the ruling of the General Counsel in this precise case, which was an informal memorandum never published in any respect. Certainly the holding in this case should not be relied upon to disprove a uniform and consistent administrative practice.

2. The statement of the Court (Op. p. 8) that there was no authority in the Farm Loan Board to make representations that the capital gains were or were not tax exempt [since] that administrative function resided only in the Treasury is incorrect both as respects administrative construction and estoppel. The Farm Loan Board, at the time these circulars were issued, was a part of the Treasury Department, and the Secretary of the Treasury was himself a member of the Board, also its *ex officio* chairman:

> "Sec. 3. That there shall be established at the seat of government *in the Department of the Treasury* a bureau charged with the execution of this Act and of all Acts amendatory thereof, to be known as the Federal Farm Loan Bureau, under the general supervision of a Federal Farm Loan Board.
>
> "Said Federal Farm Loan Board shall consist of five members, *including the Secretary of the Treasury, who shall be a member and chairman ex officio,* and four members to be appointed by the President of the United States, by and with the advice and consent of the Senate . . ." C. 245, 39 Stat. 360, Sec. 3, Appendix to Resp. Brf., p. 1.

The various circulars disclose on their face that they were issued by the Treasury Department. See, e. g., Exhibit 1 (R. 64); Exhibit 2 (R. 67); Exhibit 4 (R. 72); Exhibit 5 (R. 75). They were issued under specific mandate of statute (Sec. 3 Farm Loan Act, C. 245, 39 Stat. 360, 361, 362; See App. to Resp. Brief p. 2). And the circular letter addressed to all joint stock land banks, advising them of the ruling of the General Counsel that capital gains were exempt, bore the imprint of the Treasury

Department. Ex. 7 (R. 94). The prominence of the printing showing that these various circulars originated in the Treasury Department is far more apparent in the original exhibits than as printed in the record — which, however, is sufficiently clear to disclose the Court's erroneous assumption that the Treasury was not responsible for the representations. Moreover, by statute the Secretary of the Treasury was himself made responsible for the wording, form, printing and custody of the bonds. (Secs. 20, 21, F. L. A., C. 245, 39 Stat. 360, 377-378.) The statement on taxation contained in the bonds was among the statements relied on by respondent. (R. 63-4.) From all of these circumstances it is apparent that the Treasury was not only directly responsible for what was done but that it acted under explicit statutory authority.

The Court observes as defeating estoppel (bottom of p. 7) that "those statements [representations of the Farm Loan Board] are hardly more specific than the statute itself." This conclusion of the Court does not comport with the finding that "In making these purchases respondent relied upon statements contained in circulars and bulletins by the Farm Loan Board, *reasonably believing* that he was purchasing securities the profit upon which in case of sale would be exempt income." This statement of the Court stems directly from a finding (R. 42-3) concurred in by the Circuit Court of Appeals (R. 129). This finding is not open to challenge under the two-court rule *United States* v. *Commercial Credit Co.*, 286 U. S. 63, 67; *Texas & New Orleans R. Co.* v. *Brotherhood*, 281 U. S. 548, 558. It has not been challenged by petitioner here nor in the court below. *Olson* v. *United States*, 292 U. S. 246, 262. This being true, it is not here open to challenge that respondent's reliance on the representations of the circulars was *reasonably* induced; and since the authority for those representations cannot be questioned, this Court must, if it gives the finding the weight to which it is entitled, rule against the Government.

3. While we wish to avoid renewing in this petition matters already argued in the brief, it seems proper to meet those reasons given by the Court which advance new ideas for holding against the exemptions which respondent claims:

(a) The Court rules that "Analytically, income derived from mere ownership of the bonds is clearly different from income derived from dealings or transactions in the bonds." (Op. 2). This resort to analytical construction of the words used instead of considering them in their usual and well understood meaning departs from customary and settled principles of statutory construction. The Court itself acknowledges that Congress is presumed to have used words in their usual and well settled meaning and that the meaning of each phrase must be considered as of the time and circumstance of its use. (Op. p. 2). These principles, enunciated clearly in *Eisner* v. *Macomber,* 252 U. S. 189, 206-7, where the definition of "income" for the purpose of "its meaning in the [16th] Amendment" was considered, were aptly reviewed in *Merchants Loan & Trust Co.,* v. *Smietanka,* 255 U. S. 509, 519:

> "In determining the definition of the word 'income' . . . this Court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definition quoted, what it is believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the 16th Amendment to the Constitution."

There can be no question but that the meaning of the phrase "income derived therefrom" as used by Congress in 1916 was the historical meaning attributed thereto by the *Smietanka* and the *Macomber* cases, which was in substance again affirmed in *MacLaughlin* v. *Alliance Insurance Co.,* 286 U. S. 244, 249-50. The problem in the *Smietanka* case involved the identical type of profit here involved; that case held implicitly as well as expressly that such a profit was income derived from the property

dealt in, and that the dealing was important only as segregating the income from the capital which produced it and thus simply marked the incidence of the tax. The effect of the instant decision if allowed to stand is to unsettle this, together with the long and distinguished line of authorities supporting it.

(b) Even in applying an analytical construction of Section 26, there is apparent on the face of the opinion a mistake in the Court's reasoning. The very statement that "Analytically, income derived from mere ownership of the bonds is clearly different from income derived from dealings or transactions in the bonds" recognizes the inescapable fact that *both* types of income had their primary source *in the bonds.* The mistake of the Court lies in assuming that Section 26 reads "income derived from *ownership* of the bonds." Congress did not say "income derived from *ownership* of the bonds" should be exempt, just as it did not say "income derived from *dealings or transactions in* the bonds" should be exempt. What Congress did say was that "income derived *from the bonds*" should be exempt. This is language of inclusion, not exclusion. How can it correctly be asserted that Congress eliminated either of these two types when its language clearly encompassed both? And this is aside from the point that even if the statute did read "income derived from ownership of the bonds," it is doubtful if such language would exempt only interest; first, because if Congress had desired to exempt interest only, it well knew how to employ language perfectly clear; and second, because one of the principal attributes of ownership is the right of alienation with all the benefits flowing therefrom, *cf. Graves* v. *Elliott,* 307 U. S. 383, 386, and a tax upon the result of alienation would therefore be a tax upon ownership.

Examination of the opinion in *Willcuts* v. *Bunn* demonstrates the present error of the Court. That case simply held (1) that income tax covers gains and profits derived from sales or deal-

ings in property; and (2) that for the purpose of the claimed exemption, income from the bonds is divisible into two types: (a) that from ownership and (b) that from dealings. The words from the *Bunn* case quoted in the present opinion of the Court were directed solely to this classification of income from the bonds. If we are correct in this analysis, the reasoning of the Court in the instant case becomes inexplicable. For the very authority relied upon as holding that "income from bonds" does not embrace income from sale or surrender of the bonds is the very authority which divides income from bonds into two classes; one from dealings, and one from ownership.

The words "derived therefrom" which the Court stresses do not alter this analysis. They are simply words of identification without which all income would have been made exempt by the statute. They do not exclude capital gains simply because there had to be dealings in the bonds in order to realize them.

(c) If no ambiguity exists in a statute there is no room for construction. *United States* v. *Missouri Pacific Railroad Co.*, 278 U. S. 269, 277; *Hamilton* v. *Rathbone*, 175 U. S. 414, 419, 420; *Michigan* v. *Michigan Trust Co.*, 286 U. S. 340, 343. See also 25 R. C. L. 959 and long list of cases cited. Where the meaning is clear courts are not permitted to search for a meaning beyond the statute itself. *Caminetti* v. *United States*, 242 U. S. 470, 491. This rule applies not only to tax acts, *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 89, but even to penal and other statutes calling for strict construction, *O. S. C. Line* v. *United States*, 300 U. S. 98, 101, for "if the language is clear it is conclusive," *United States* v. *Hartwell*, 6 Wall 395, 396.

As pointed out, supra, words are to be given their usual meaning. In view of the Federal Reserve Act of 1913, from which the language in Section 26 was taken, and in view of the judicial definition of the phrase in *Eisner* v. *Macomber*, supra, and *Merchants Loan & Trust Co.*, v. *Smietanka*, supra, there could have

been no doubt in 1916 as to the meaning of the phrase here involved. The *Bunn* case, decided in 1931, could not possibly have created such a doubt as to its meaning in 1916.

This being true, there was no occasion for the Court to go outside Section 26, and invoke the principle of *pari materia* in construing the statute. *Barnes* v. *Railroad Companies,* 17 Wall 294, 302. Rules of interpretation are for the purpose of resolving, not creating an ambiguity. *Caminetti* v. *United States,* supra, *MacKenzie* v. *Hare,* 239 U. S. 299. In line with the above authority it has been specifically ruled that the doctrine of construing together statutes in *pari materia* (itself only one of a number of canons of construction) has no application where the words of the statute under consideration are so plain as to not admit of construction. *Barnes* v. *Railroad Companies,* supra; *Greenport Basin & Construction Co.* v. *United States,* 260 U. S. 512.

Moreover, the statement of the Court (Op. p. 3) that the revenue acts are in *pari materia* with Section 26 of the Farm Loan Act is true only to the limit and extent that both deal with a tax exemption in respect to interest on farm loan bonds. The revenue acts, however, do not purport to deal with the entire tax exemption accorded by Section 26. The acts are not in *pari materia* as to other matters which are exempted. The revenue acts do not necessarily show an understanding on the part of Congress, (which are shown by the Revenue Act of 1938, Sec. 817) as to the extent of the exemption accorded by Section 26.

It is respectfully urged that the Court has given entirely too much weight to subsequent revenue acts which apparently it has considered as "the legislative setting" of Section 26 (Op. p. 3, 7). The use of the word "interest" in the income tax statute is no more a "legislative setting" for the Farm Loan Act than the use of the word "income" in the Farm Loan Act is a "legislative setting" for the word "interest" in the Income Tax Acts. Indeed, not as much, for the legislative setting which the Court refers

to did not exist at the time of the passage of Section 26. As a matter of fact the legislative setting of Section 26 comprises the dual facts that the words of that section originated in the Federal Reserve Act where they had been given the broad meaning for which we contend, and that Congress, had it chosen to give a narrower exemption had ample precedent in the Federal Reserve Act itself, and in other statutes, which expressly exempted only interest.

(d) In effect, the Court's decision herein is that the Revenue Act of 1916 repeals *pro tanto* the broader exemption contained in Section 26. The result is to overrule the well established principle that a special statute, even though earlier in point of time, controls a general statute. *Rodgers* v. *United States,* 185 U. S. 83, 87-89, *Washington* v. *Miller,* 235 U. S. 422.

The exemptions of Section 24 (a), (b), Revenue Act of 1928, are perfectly clear standing alone. Section 26 of the Farm Loan Act is likewise perfectly clear standing alone. Neither is inconsistent with the other; one simply goes further than the other. The former, a general statute, exempts interest; the latter, the special statute, income. Neither contains words of repeal or interpretation; and since implied repeals are not favored, there is presented a clear case for the application of the fundamental doctrine that the special act will be deemed an exception to and will prevail over the general act. This, however, the Court has failed to do. It has noted what seemed to it an inconsistency between the revenue acts and the Farm Loan Act, calls the former the "setting" of the latter, and proceeds to "analyze" Section 26 based on a statement, not at all in point, from *Willcuts* v. *Bunn.*

CONCLUSION

In conclusion we respectfully ask this Court to reconsider its decision in the above matter. It has, in effect, said that the word "income" has one meaning for taxing statutes but quite another for exemption statutes even though they are framed to meet the very tax asserted. In doing so it is our view that the opinion has disregarded applicable principles of statutory construction upon which the taxpayer—as all persons governed by statute—was entitled to rely. Thus, respondent was entitled in purchasing the bonds confidently to rely upon the meaning of the words "income derived therefrom" as understood at the time the Farm Loan Act was adopted, which is the meaning ascribed to them by this Court in *Merchants' Loan & Trust Co.* v. *Smeitanka,* 255 U. S. 509, 520. We believe the Court is not justified in analyzing these very words in the light of an entirely unrelated later decision. We believe this Court was not entitled in effect to set aside the concurrent finding of both courts below that respondent "reasonably" believed "that he was purchasing securities the profit upon which in case of sale would be exempt income." We think that as the special statute was entirely clear on the subject, the taxpayer was entitled to assume that he would not be controlled by general revenue statutes. We believe that the scrupulous observance of the Government's policy and bargain in these bond issues and the impartial administration of the law should both have forbidden the necessity for bringing this case; but, it having been necessary to bring the case to preserve his rights, respondent feels entitled to rely on this Court for security in the vindication of these principles of law.

Respectfully submitted,

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

CERTIFICATE OF COUNSEL UNDER RULE 33

The foregoing petition for rehearing is filed in good faith for the reasons therein set forth, and not for the purpose of delay.

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

BLANK PAGE

SUPREME COURT OF THE UNITED STATES.

No. 13.—October Term, 1940.

The United States of America, Petitioner, *vs.* Ashby Oliver Stewart.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 12, 1940.]

Mr. Justice Douglas delivered the opinion of the Court.

This case is here on certiorari to resolve a conflict of the decision below (106 F. (2d) 405) with *Stern Brothers & Co.* v. *Commissioner*, 108 F. (2d) 309.

During the year 1930 respondent purchased farm loan bonds issued by joint-stock land banks under the Federal Farm Loan Act of 1916 (39 Stat. 360). The purchases were made for the prospective increment to the bonds and not for their interest. At the time the purchases were made the banks were in receivership. The bonds were acquired at prices substantially below par. In making these purchases respondent relied upon statements contained in circulars and bulletins issued by the Farm Loan Board, reasonably believing that he was purchasing securities the profit upon which in case of sale would be exempt income. A part of the bonds so purchased, with their appurtenant coupons, was sold in 1931; and a part was surrendered in that year to the receiver of the issuing bank in exchange for cash paid to respondent "under and pursuant to the covenants contained" in the bonds. Each of these transactions resulted in a profit to respondent.[1] The Commissioner held that those gains were taxable income. Consequently respondent included them in his income tax return for the year 1931 and claimed a refund. On disallowance of that claim, this suit for refund was instituted. The District Court determined that the gains so realized were income and taxable. 24 F. Supp. 145. The Circuit Court of Appeals reversed.

Sec. 22(a) of the Revenue Act of 1928 (45 Stat. 791) includes in gross income "gains, profits, and income derived from • • •

[1] These purchases were for respondent and his wife who filed separate returns for the year in question.

sales, or dealings in property, whether real or personal." Sec. 22(b)(4) exempts from taxation "Interest upon * * * securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended."

If those two sections are controlling, it is clear that respondent is taxable on these gains, for they fall squarely within the definition of gross income contained in § 22(a) and they are not "interest"[2] within the meaning of § 22(b)(4). But respondent places his main reliance on § 26 of the Federal Farm Loan Act which provides that "farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." It is urged that the gains here involved were "income derived" from the bonds within the meaning of that section.

We disagree with that conclusion. It is our view that under § 26 respondent is entitled to an exemption only for interest on the bonds.

To be sure, "income" is a generic term amply broad to include capital gains for purposes of the income tax. *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509. It is likewise true that Congress will be presumed to have used a word in its usual and well-settled sense. *Old Colony Railroad Co.* v. *Commissioner,* 284 U. S. 552; *Deputy* v. *du Pont,* 308 U. S. 488. But § 26 does not exempt simply "income"; it exempts the bonds and the "income derived therefrom." Analytically, income derived from mere ownership of the bonds is clearly different from income derived from dealings or transactions in the bonds. As stated in *Willcuts* v. *Bunn,* 282 U. S. 216, 227-228:

"The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite gen-

[2] The record does not show what portion, if any, of the sums received on the sale or on the exchange of the bonds and appurtenant coupons was received as payment on accrued interest. Nor did the complaint allege that any portion of the sums received was exempt because it was "interest" on the bonds. Hence that point was not raised below or here.

erally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.' *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531."

True, the *Bunn* case dealt only with the alleged constitutional inhibition against taxation of capital gains on municipal bonds and not with a specific statutory exemption. But its analysis is cognate here as indicating that, in absence of clear countervailing evidence, an exemption of "income derived" from a security does not embrace "income derived" from transactions in that security.

There are no circumstances here which should make the reasoning of the *Bunn* case inapplicable.

The Revenue Act of 1916 (39 Stat. 756) was enacted shortly after the Farm Loan Act by the same Congress and at the same session.[3] Sec. 2 of that Act, like § 22(a) of the 1928 Act, included in taxable income "gains, profits, and income derived from * * * sales, or dealings in property." And § 4 of that Act, like § 22(b)(4) of the 1928 Act, exempted from taxation "interest upon * * * securities issued under the provisions of the Federal farm loan Act." It is clear that "all acts *in pari materia* are to be taken together, as if they were one law." *United States* v. *Freeman*, 3 How. 556, 564. That these two acts are *in pari materia* is plain. Both deal with precisely the same subject matter, *viz.*, the scope of the tax exemption afforded farm loan bonds. The later act can therefore be regarded as a legislative interpretation of the earlier act (*Cope* v. *Cope*, 137 U. S. 682, 688; Cf. *Stockdale* v. *Insurance Companies*, 20 Wall. 323, 331-332) in the sense that it aids in ascertaining the meaning of the words as used in their contemporary setting.[4] It is therefore entitled to great weight in resolving any ambiguities and doubts. Cf. *United States* v. *Stafoff*, 260 U. S. 477, 480. In that view the express exemption of interest alone makes tolerably clear that capital gains are not exempt.

---

[3] The Farm Loan Act became law on July 17, 1916, the Revenue Act of 1916 on September 8, 1916.

[4] It should be noted in this connection that the exemption of "interest" contained in § 4 of the 1916 Act was continued in each subsequent Revenue Act until 1934. Sec. 213(b)(4), Revenue Act of 1918 (40 Stat. 1057, 1065); § 213(b)(4), Revenue Act of 1921 (42 Stat. 227, 238); § 213(b)(4), Revenue Act of 1924 (43 Stat. 253, 268); § 213(b)(4), Revenue Act of 1926 (44 Stat. 9, 24); § 22(b)(4), Revenue Act of 1928 (45 Stat. 791, 798; § 22(b)(4), Revenue Act of 1932 (47 Stat. 169, 178). By § 22(b)(4) of the Revenue Act of 1934 (48 Stat. 680, 687) the exemption was generalized so as to include interest on obligations of any federal corporation which is an instrumentality of the United States, subject to the limitation that interest is exempt only if and to the extent provided for in the acts of Congress authorizing the issuance

In support of the contrary view great stress is placed on the legislative history of § 26. Extensive references are made to the hearings on this bill and to the debates in Congress. Typical are the statements or criticisms that the bill gave "these investments a distinct advantage over other investments",[5] that the exemption provision was important,[6] that maintenance of a market for the bonds was desirable,[7] that the exemption was too broad.[8] These comments, however, are inconclusive. They are not sufficiently discriminating in their analysis or criticism to throw light on the narrow issue involved here.

Respondent's resort to administrative interpretation of § 26 is equally unproductive. No established administrative practice is shown. The holding of the unpublished memorandum[9] of the General Counsel of the Bureau of Internal Revenue relied upon is not precisely in point, even were we to assume that it is entitled to authoritative weight.[10] It merely ruled that a joint-stock land bank was not taxable on gains from purchases of its own bonds. And when the question of the taxability of an individual on his capital

---

of such obligations. The Senate Committee (S. Rep. No. 558, 73d Cong., 2d Sess., pp. 23-24; Internal Rev. Bull., Cum. Bull. 1939-1, Part 2, p. 604) made the following comment on that change:

"This is merely a clarifying change made by the House. Under the language of this section, as contained in existing law, interest on securities issued under the Federal Farm Loan Act, or such Act as amended, is expressly excluded from gross income and thereby made exempt from the income tax. Other Acts have been enacted which also exempt the interest on obligations issued thereunder from tax. In order to bring the section into accord with the Acts authorizing such exemptions and to avoid the necessity of referring to all such Acts, a general provision has been inserted by the House excluding from gross income the interest upon the obligations of a corporation organized under Act of Congress if such corporation is an instrumentality of the United States; subject to the limitation, however, that the interest is exempt only to the extent provided for in the Acts of Congress authorizing the issuance of such obligations."

5 Cong. Record, 64th Cong., 1st Sess., Vol. 53, Part 8, p. 7312. And see H. Rep. No. 630, 64th Cong., 1st Sess, p 8.

6 Joint Hearings before Sub-Committees of the Committees on Banking and Currency, Rural Credits, 63d Cong., 2d Sess., pp. 95-97; S. Doc. No. 380, 63d Cong., 2d Sess., Agricultural Credit, Rep. U. S. Commission, pp. 17, 33.

7 H. Doc. No. 679, 63d Cong., 2d Sess., pp. 15, 16.

8 Cong. Record, *op. cit., supra*, note 5, pp. 6850, 7311. Nor is it significant that substitute bills were offered (Cong. Record, *op. cit., supra*, note 5, pp. 7385, 7387; S. 4061, 63d Cong., 2d Sess.) by the terms of which "interest" was exempted. These were overall substitutes. Therefore the implication is not warranted that the failure of their adoption was due to the desire of Congress to grant a broader exemption than "interest".

9 This is reproduced, so far as material here, in S. Hearings, Committee on Finance, 75th Cong., 3d Sess., H. R. 9682, Part 4, pp. 619-621.

10 See Helvering *v.* New York Trust Co., 292 U. S. 455, 468.

gains from sales of these bonds was raised less than two years later, another such ruling was issued to the effect that he did not have the benefit of any exemption.[11]

Nor is respondent materially aided by the change in § 26 made by § 817 of the Revenue Act of 1938 (52 Stat. 447, 578). That amendment provides that "all income, except interest, derived" from such bonds shall be included in gross income.[12] It is urged that this amendment is affirmative recognition by the Congress that § 26 exempts these capital gains. But here again the legislative record is ambiguous and hence inconclusive. The purpose of § 817, as originally introduced, clearly was to make certain that capital gains realized by joint-stock land banks on transactions in their own obligations would not be exempt.[13] The section was amended on the floor of the Senate to its present form on the suggestion that "per-

---

[11] See Agricultural Securities Corp. *v.* Commissioner, 39 B. T. A. 1103, 1111.

[12] This amendment is prospective only. It provides:

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation."

[13] S. Rep. No. 1567, 75th Cong., 3d Sess., p. 47. This report clearly indicates that the Committee was of the view that under § 26 joint-stock land banks were exempt from capital gains resulting from purchases of their own obligations. A change in that regard was clearly intended, for the Committee said, p. 47:

"This section subjects to Federal income taxation the capital gain realized by a joint-stock land bank on the purchase of its own obligations or of mortgages made by it. It has been brought to the attention of the committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation, is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint-stock land banks, such income is exempt. The committee is of the opinion that such income ought to be taxed."

The Committee draft of § 817 (then § 816) provided for that change as follows (H. R. 9682, 75th Cong., 3d Sess.):

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, gain realized on the acquisition by a joint-stock land bank of obligations issued by it or mortgages made by it, if such obligations or mortgages are made or issued after the date of the enactment of this Act, shall not be exempt from Federal income taxation."

As indicated, *supra*, note 9, the unpublished memorandum of the General Counsel of the Bureau of Internal Revenue ruling that a joint-stock land bank was not taxable on gains from purchases of its own bonds was before the Senate Committee. Cf. the recommendation made to the Committee, S. Hearings, *op. cit., supra*, note 9, pp. 614, 615.

haps the language is not as broad as it should be."[14] The purpose of the amendment may well have been to clarify the doubtful and uncertain status of capital gains which were not covered by the Committee's recommendation. There is no clear and convincing evidence that it was designed to change existing law, so far as these other categories of capital gains were concerned. But even if a contrary implication were to be assumed, it would not override so belatedly the clear inference, based on a long series of revenue acts exempting only interest, that capital gains were taxable.

Respondent further argues that comparison of other exemption statutes with the language of § 26 reinforces the view that these capital gains are exempt. In that connection our attention is called to numerous statutes—some exempting only bonds[15] and others exempting principal and interest;[16] some exempting a corporation, "including the capital stock and surplus therein, and the income derived therefrom,"[17] and others[18] containing somewhat similar exemptions for the corporation but only an exemption as to principal and interest for its bonds; and still others[19] containing the same kind of exemption as § 26 of the Farm Loan Act. From this painstaking review respondent argues that where Congress has de-

14 Statement by Senator King, member of the Committee on Finance, Cong. Record, Vol. 83, 75th Cong., 3d Sess., p. 4959. When Senator King offered the amendment, he gave the following explanation (*id.* p. 5174):

"The bill as reported subjected to Federal income taxation capital gains realized by a joint-stock land bank on obligations issued and mortgages made by it after the date of enactment of the act. The effect of the amendment is not only to tax that gain but also to tax gain realized by another joint-stock land bank or by an individual or corporation which itself is not exempt from Federal taxation. Thus, gain on a sale of such a joint-stock land bank bond by an investor is subject to tax. The amendment continues the present provision of law under which interest on such bonds and mortgages is exempt from Federal taxation."

15 Statutes governing Panama Canal Toll Bonds (32 Stat. 481, 484; 36 Stat. 11, 117) and Postal Savings Bonds (36 Stat. 814, 817) are cited.

16 Reference is made to various statutes including those pertaining to Treasury notes (38 Stat. 251, 269) and several of the Liberty loans (40 Stat. 35; 40 Stat. 288, 291; 40 Stat. 1309, 1310).

17 Federal Reserve Act of December 23, 1913 (38 Stat. 251, 258). And see Bankhead-Jones Farm Tenant Act of July 22, 1937 (50 Stat. 522, 528); Agricultural Adjustment Act of 1938 (52 Stat. 31, 75).

18 Reference is made to the War Finance Corporation Act of April 5, 1938 (40 Stat. 506, 511); Reconstruction Finance Corporation Act of January 22, 1932 (47 Stat. 5, 9); Home Owners' Loan Act of June 13, 1933 (48 Stat. 128, 130).

19 Federal Farm Mortgage Corporation Act of January 31, 1934 (48 Stat. 344, 347); Commodity Credit Corporation Act of March 8, 1938 (52 Stat. 107, 108).

sired to exempt only "interest" it has said so and where it has intended to grant a broader exemption it has used the word "income"; that statutes exempting only "interest" have a narrower meaning than those exempting "income"; and that this long and recurrent legislative practice discloses a clear design on the part of Congress to draw distinctions and to shape the various exemptions to suit its differing policy in divers situations.

Suggestive as this analysis is, it is entitled to little weight. No mere collation of other statutes can be decisive in determining what the instant statute means. The meaning of each phrase must be closely related to the time and circumstance of its use. The phrase "income derived therefrom" as used in § 26 clearly has taken on coloration from the express exemption for nearly a quarter century of only interest on these bonds. We have no occasion to intimate an opinion as to the meaning of other similar statutes. It is sufficient here to note that in another legislative setting "income derived" from bonds may or may not be synonymous with "interest" on bonds. That must necessarily be dependent on a host of factors which only a minute scrutiny of the particular legislative scheme would reveal. For this reason the fact that the same Congress which in 1938 amended § 26 granted an exemption to another federal instrumentality[20] couched in the identical language of the original § 26 is merely a straw in the wind. So far as the instant bonds are concerned, that in itself is entitled to little weight as against the long standing express exemption in successive revenue acts of interest alone.

Respondent also stresses the fact that circulars, prepared and distributed by the Farm Loan Board "advising investors of the merits and advantages of farm loan bonds",[21] stated that these bonds and their income were "free from all forms of taxation" including the income tax, that "this exemption is complete", etc. As we have said, it was found that respondent relied upon such statements reasonably believing that capital gains would not be taxable. But aside from the fact that those statements are hardly more specific than the statute itself, they cannot be accorded the

[20] Commodity Credit Corporation, *supra*, note 19.

[21] Pursuant to the authority vested in the Federal Farm Loan Board by § 3 of the Act.

weight of uniform and long standing administrative treatment.[22] There was no authority for the Board to make representations that capital gains were or were not tax exempt. That administrative function resided only in the Treasury. An officer or agency of the United States to whom no administrative authority has been delegated cannot estop the United States even by an affirmative undertaking to waive or surrender a public right. *Utah* v. *United States,* 284 U. S. 534, 545-546; *Wilber National Bank* v. *United States,* 294 U. S. 120, 123-124.

We return to our conclusion that the weight of these various considerations leans to the view that only interest is exempt. The cumulative strength of the several factors urged by respondent is not such clear evidence of Congressional purpose as to make inapposite the application of the reasoning of *Willcuts* v. *Bunn, supra,* to this situation. In that posture of the case, respondent has succeeded only in casting some doubt on the proper construction of the statute. Yet those who seek an exemption from a tax must rest it on more than a doubt or ambiguity. *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; 163 U. S. 416, 423. Exemptions from taxation cannot rest upon mere implications. *United States Trust Co.* v. *Helvering,* 307 U. S. 57, 60. As stated by Mr. Justice Cardozo in *Trotter* v. *Tennessee,* 290 U. S. 354, 356, "Exemptions from taxation are not to be enlarged by implication if doubts are nicely balanced." And see *Pacific Co., Ltd.* v. *Johnson,* 285 U. S. 480, 491. Hence broad, generalized statutory exemptions have frequently been construed narrowly and confined to those situations where the subject matter of the exemption was directly, not indirectly or remotely, involved. *Murdock* v. *Ward,* 178 U. S. 139; *Hale* v. *State Board of Assessment and Review,* 302 U. S. 95; *United States Trust Co.* v. *Helvering, supra.* The exemption contained in § 26 of the Farm Loan Act must be so construed.

For these reasons the challenged judgment must be

Reversed.

Mr. Justice ROBERTS is of opinion that the judgment should be affirmed on the grounds stated by the Circuit Court of Appeals in its opinion below, 106 F. (2d) 405.

---

[22] Nor can the casual statement by the Secretary of the Treasury, in the course of a Congressional hearing on the Revenue Act of 1918, to the effect that "Land bank bonds carry a wider exemption than Liberty bonds." (S. Hearings, H. R. 12863, 65th Cong., 3d Sess., Part 4, p. 117) carry authoritative weight, as it does not even purport to be a discriminating analysis of this problem in its various aspects.